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# THE CANADIAN CHARTERED ACCOUNTANT



The Accountant and the Farmer  
Currency Exchange Convertibility  
The Budget: Looking in a New Direction  
Sales, Production and Financial Planning  
Long-Range Planning for Railway Accounting  
Contrasts in U.K. and Canadian Annual Reports

ADMINISTRATIVE ACCOUNTING: Cost Accounting  
ACCOUNTING RESEARCH: The Independence of the Auditor  
TAX REVIEW: The Budget, 1959

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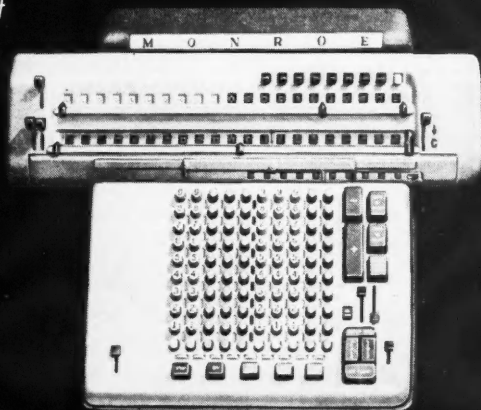
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# THE CANADIAN CHARTERED ACCOUNTANT

VOL. 74, No. 6

JUNE, 1959

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The Canadian Chartered Accountant, June 1959. Published monthly by the Canadian Institute of Chartered Accountants. Chairman, Editorial Board, H. S. Moffet, F.C.A.; Editor, Renny Englebert; Asst. Editor, Jean Vale. Advertising Representative, E. L. Vetter. Editorial and Business office: 69 Bloor street east, Toronto 5. Subscription rates: \$6 a year; 60 cents a copy. Printed by General Printers Limited and mailed at Oshawa, Ontario. Authorized as second class mail by the Post Office Department, Ottawa. Opinions expressed are not necessarily endorsed by the Canadian Institute.



## IN THIS ISSUE

### W. O. TWAITS (page 499)

"While sales planning may be the starting point, it cannot be done by itself but only in conjunction with all other factors and with equal consideration to the company's financial resources, a recognition of the lead time necessary to provide a given sales volume and an assessment of the company's competitive strength." William O. Twaits, the author quoted above, proceeds in his article "Sales, Production and Financial Planning" to outline a way of fitting these factors into corporate programming and shows how the effectiveness of management is judged by the ability to plan concurrently in all three areas. He emphasizes that planning within an organization is not divisible by functions but is a practical down-to-earth procedure which makes a team approach absolutely vital.

Mr. Twaits writes with authority. After graduating in 1933 from the University of Toronto with a B.Com. degree, he joined Imperial Oil Limited, starting in the packaging plant and moved to the technical and research laboratories and later to production control and refinery operations. He rose to become assistant economic coordinator, assistant manager — supply department, management assistant — production department (western division), in that order. In 1950 he was elected a director of the company and appointed general manager of the producing department. Then in 1952 he was named vice-president of the company, moved up to his present posi-

tion of executive vice-president at the end of 1955 in which capacity he takes an active part in the marketing phase of the company's business. Mr. Twaits is president of the Canadian Arthritis and Rheumatism Society.

### S. A. SENN, C.A. (page 505)

The movement towards better presentation in corporate annual reporting in Canada has stirred up considerable interest in recent years and has been encouraged by the profession and through awards offered by *The Financial Post*. A number of awards are also made annually by *The Accountant* in the United Kingdom and *The Financial World* in the United States for the best reports in each country. In "Contrasts in United Kingdom and Canadian Annual Reports", Stanley A. Senn looks at company law in both countries and shows some interesting differences which are reflected in their annual reports. The author considers the Canadian report markedly superior to the average presentation in the United Kingdom and gives his reason for this observation. His views on this matter, however, are subject to some dispute. A recent report shows that a number of professional stock consultants now think there is more to be gleaned from an intelligent reading of a British company's annual report than from any of the lush surveys put out at frequent intervals by North American firms.

Mr. Senn is associated with Deloitte, Plender, Haskins & Sells, Toronto, and has been a member of the Institute of Chartered Accountants of Ontario since 1955. He was formerly with Deloitte, Plender, Griffiths and Co. in London and more recently with Haskins & Sells in Chicago. An article on "Differences in British and United States Auditing Practice" appeared in *The Journal of Accountancy* in 1955.

*Continued on page 482*



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**R. H. CRANDALL, C.A. (page 510)**

"The Budget: Looking in a New Direction" is likely to attract the attention of our readers for the way Robert H. Crandall works concisely and systematically through his subject, starting with the requirements for good budgeting, continuing with the more detailed problems involved in sales, expense and cash budgeting. He concludes with the importance of good follow-up in order to compare actual with planned results and evaluates the reasons for variances. Mr. Crandall admits that budgeting is hard work but defines it as "worthwhile hard work which leads to a more organized approach to the conduct of the business".

The author is associated with Woods, Gordon & Company and specializes in office methods, organization and management reports. A graduate in Commerce from Queen's University, Kingston, he studied later at the London School of Economics on a Beaverbrook Overseas Scholarship. On his return to Canada in 1952 he joined Clarkson, Gordon & Company, Toronto, and obtained his certificate in chartered accountancy in 1955. He is a member of the Institute of Chartered Accountants of Ontario.

**L. J. MILLS, O.B.E., F.C.A. (page 517)**

Not many people, industrial accountants included, we venture to suggest, have more than a hazy idea of the massive detail work involved in railway revenue accounting. Freight is the big business, and in "Long-Range Planning for Railway Revenue Accounting", Leonard J. Mills discusses what is being done to convert a basically manual operation for Canadian National Railways freight accounting to a highly com-

*Continued on page 484*



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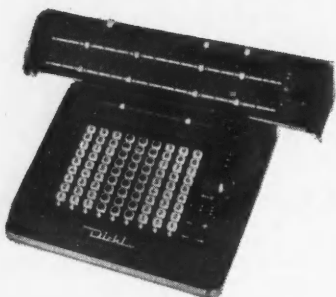
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*Continued from page 482*

plex electronic data processing system. All mass transportation companies have the same general problem of controlling, auditing and summarizing passenger and freight revenues. The need today, the author indicates, is to present an integrated procedure which will substantially increase efficiency and reduce accounting costs.

Mr. Mills has the advantage of having studied his subject while serving with two large Departments of the Federal Government: first, as financial adviser to the Deputy Minister of Veterans Affairs and later as director of financial services to the Post Office Department. Two years ago he joined the Canadian National Railways as assistant comptroller-revenues and in April of this year was appointed comptroller for the company. He has been a member of the Institute of Chartered Accountants of Ontario since 1933 and in 1956 was elected a Fellow of the Institute.

**W. A. GREGORY, C.A. (page 522)**

With "The Accountant and the Farmer", Walter A. Gregory explains how proper accounting techniques will aid the farmer in measuring the efficiency of his farm and locate weaknesses so that he can improve his operation. He points out that the most needed and useful system is one in which the farmer can record his receipts and disbursements simply and systematically. The common complaint heard from the farmer is that he has neither the time nor facilities for elaborate records. He works and thinks in terms of crop rotation and animal husbandry, and his activities are not the kind that develop a love of detail. However, now that farming is becoming more and more a complex business, efficient management

on the farm is as important as it is in manufacturing, and the author examines the advantages of proper accounting and shows how the accountant can play his part in achieving this.

Mr. Gregory is a partner in Ward & Gregory and lives in the Ontario farming community of Ridgetown. Active in business and community affairs in the district, he has lectured on farm accounting and income taxes at the Western Ontario Agricultural School. He received his certificate in chartered accountancy in 1952 and is a member of the Institute of Chartered Accountants of Ontario.

#### H. D. SCOTT (page 527)

There has always been some misunderstanding of the conditions under which money could be transferred from one country to another since the establishment of exchange controls was first introduced in practically all western countries at the outbreak of World War II. From time to time there has been gradual relaxation of controls and at the end of 1958 further important steps were taken along these lines by the principal western countries. In "Currency Exchange Convertibility", H. Duke Scott discusses what convertibility means and the effects it will have on world trade. The main advantage to this country, he told the Editor, is that there is no longer any reason for foreign governments to plead that they do not have dollars in order to avoid importing goods from Canada; in other words, the shortage of dollars has lost its force. Such trading obstacles as now exist are confined to tariffs, quotas, subsidies and other direct barriers.

Mr. Scott, since joining the Imperial Bank of Canada in 1914, has spent his entire career in "international" banking and, as superintendent of foreign

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*Continued from page 485*

business for the bank, was in charge of all its international operations. He has travelled extensively in most countries of the world and served on many Canadian and international associations interested in foreign trade and finance. He returned recently from a visit to West Germany. In May he was appointed assistant general manager of the bank's international department.

### EDITORIAL (page 495)

This month's editorial "Salute to the S.I.C.A." deals with the growth and development of the Society of Industrial and Cost Accountants which has built up a high reputation for itself during its comparatively short history. In this, as the editorial indicates, chartered accountants have played no small part and the Editors are grateful to Kris A. Mapp, F.C.A. for giving readers this outline of the activities of the Society. He is well qualified to do so, for, as its president for 4 years — from 1934 to 1938, he was closely connected with its work and has continued to take a keen interest in its progress.

Over a long period of years Mr. Mapp, senior partner in Barber, Mapp and Mapp, Toronto, has been active in the affairs of the profession. He is a past president of the Institute of Chartered Accountants of Ontario and the Canadian Institute of Chartered Accountants and has been a member of the Ontario Institute since 1920. In 1929 he was elected a Fellow of the Institute.

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## NOTES AND COMMENTS



### Recent Publications

The American Institute of Certified Public Accountants has announced the publication of "Guides to Successful Accounting Practice", a book which shows how successful accounting practitioners handle some of the more difficult aspects of practice management.

The book is based on material drawn from the Practitioners Forum, a regular column in *The Journal of Accountancy* since 1954. Edited by Bernard B. Isaacson, of Wilmington, the guide presents the opinions, methods and time-saving techniques developed by experienced accountants to make their practices more efficient and profitable.

"Guides to Successful Accounting Practice" is available at \$3.50 from the American Institute of Certified Public Accountants, 270 Madison Avenue, New York 16.

"The Effect of Selling Prices on Profit" is the second in a series of small booklets published by The Glidden Company Limited. It deals in large part with the pricing of merchandise and is fully up to the standard of the previous booklet "Reducing the Risk in Business". Succeeding booklets, to be published at monthly intervals, will endeavour to outline, step by step, the importance of certain basic facts in business and have been written especially for the retail merchant. The young accountant or student-in-accounts would also do well to read these booklets, copies of which can be obtained by writing to The Glid-

den Company Limited, 351 Wallace Avenue, Toronto 9. The entire series has been prepared by Victor L. Johnson, C.A., chief accountant for the company.

The Federated Council of Sales Finance Companies has recently published a 16-page booklet "Purchase Credit and the Sales Finance Company", copies of which may be obtained by writing to The Federated Council of Sales Finance Companies, 1011 Commonwealth Building, 77 Metcalfe Street, Ottawa. The booklet explains that the sales finance company functions in two ways: at the factory by financing the sales of durable goods from the manufacturer to the dealer and at the retail level by financing the instalment sale of durable goods from the dealer to the individual consumer.

### Operational Research

The first annual meeting of the newly formed Canadian Operational Research Society took place at the University of Toronto on May 7 and 8. President of the society is Dr. O. M. Solandt, Canadian National Railways.

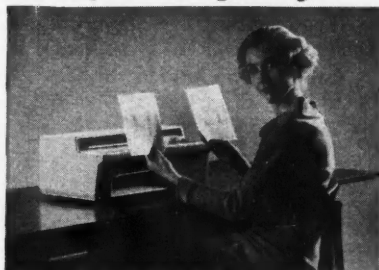
### Queen's University Summer Seminars

A 3-day income tax seminar and a 5-day course designed to enlarge the outlook of promising middle-management personnel will be held from June 8-10 and from June 15-19, respectively, at Queen's University, Kingston. The tax seminar will open

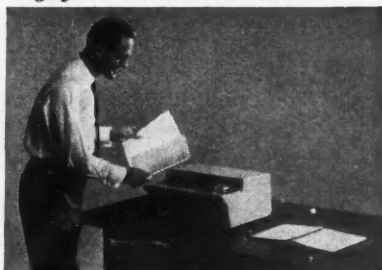
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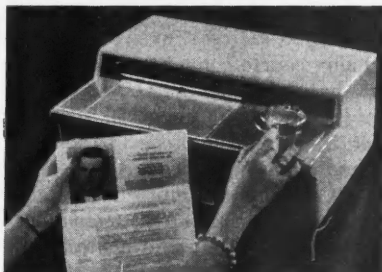
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*Continued from page 458*

with an address by J. Harvey Perry on "Tax Trends, 1959", to be followed in the afternoon by a talk "Avoidance versus Evasion" by R. deWolfe MacKay. An evening paper will be given by Professor W. G. Leonard, F.C.A. on "An Introduction to Income Measurement for Tax Purposes". Subjects for discussion on the second and third days are: "Depreciation and Capital Cost Allowances", by W. L. McDonald, F.C.A.; "Inventories", by G. P. Keeping, F.C.A.; "Syndicate Discussions of Problems in Income Measurement", by Marcel Belanger, C.A. and E. J. Benson, C.A.; "Payments on Account of Capital", by C. L. King, F.C.A.; "Reserves, Allowances and Provisions under the Income Tax Act", by Marcel Belanger, C.A. and Professor J. E. Smyth, F.C.A.; "Income for Tax Purposes — An Appraisal and Forward Look", by A. Willard Hamilton, C.A.

In an introduction to the program on "Perspective for Management", the planning course committee emphasize that the objects of the course are to afford a group of about 50 men to meet, free from the preoccupations of job and family, to exchange views and engage in vigorous argument on some of the newer management techniques of analysis, planning and control and the human problems within the business organization. The subjects chosen for consideration are "The University's Obligation to Business", by W. A. Mackintosh, principal of Queen's University; "Management in Today's Economic and Governmental Environment", by C. A. Curtis and L. A. Skeoch; "Recent Economic Experience and Its Lessons" by F. A. Knox; "The Processes of Technological Change", by E. W. R. Steacie, president, the National Research Council of Canada; "Physical Resources and Industrial Policy", by E. G. Pleva; "The Impact

of Changing Resources and Technology", by P. W. Blaylock; "Managerial Planning and Control", by F. S. Capon, C.A. and G. H. Cowperthwaite, C.A.; "Mathematical Aids and Approaches to Management", by R. R. Crane and W. R. Hydeman. The closing sessions on Friday, June 19 will include a discussion on "The Human Side of Enterprise", by D. M. McGregor, professor of industrial management, Massachusetts Institute of Technology, and "Management's Responsibilities in Modern Society", by H. I. Ross, C.A.

### **Business Show in Toronto**

Chartered accountants are specially invited to attend the Canadian National Business Show at the Automotive Building, Canadian National Exhibition grounds, Toronto, from June 8 to 10. More than 100 exhibitors will display business equipment, furniture, machines, systems and services at this show which is under the sponsorship of the Canadian Business Equipment Manufacturers Association Inc. Tickets may be obtained through the Association's office at 1819 Yonge Street, Toronto 7.

### **1958 Annual Reports and the C.I.C.A.**

Reference to the Canadian Institute of Chartered Accountants appeared in two 1958 annual reports. In announcing accounting changes, Crown Zellerbach Canada Limited said that starting with 1958 there has been a change in their basis of reporting earnings. "The company follows the practice of depreciating capital assets over their normal life by equal annual charges to costs (straight line depreciation). However, the Income Tax Act allows, as a deduction, higher depreciation charges in the

*Continued on page 492*

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early years of an asset's normal life, with a reduced charge in the later years (diminishing balance depreciation). Therefore, for a period immediately following substantial new capital expenditure the depreciation allowed for tax purposes will be in excess of that charged to costs. The net effect is a deferment of taxes on income. The 1958 statement of income, in addition to the provision for current income taxes, includes a charge of \$1,635,000 for such deferred income taxes. This is in line with the practice of other companies in Canada and in accordance with the basis of reporting recommended by the Canadian Institute of Chartered Accountants."

The Great Lakes Paper Company Limited in an introduction to definitions of technical terms had this to say: "Listed below are the principal

terms used in this report with definitions of our meaning. They are listed in the general sequence of their appearance in the report, rather than alphabetically. For wider information we recommend 'Accounting Terminology', issued by the Canadian Institute of Chartered Accountants and 'How to Read Financial Statements', compiled by the Investment Dealers Association of Canada."

### In the News

GORDON E. BROWNING, F.C.A. (Ont.), Sudbury, has been elected president of the Ontario Chamber of Commerce. This is the first time a chartered accountant has held this position.

### Month End Rates of Exchange

Beginning this month, members will be provided in this column with the nominal rates of foreign currencies as at the close of business on the last trading day of each month. We feel that this service should be an extremely practical one for accountants required to express foreign currency amounts in terms of Canadian funds for income tax and other purposes.

#### CURRENCY EXCHANGE RATES

The following nominal rates of exchange are supplied by The Canadian Bank of Commerce, International Department, Head Office, Toronto, as at 4 p.m., April 30, 1959: Australia (pound) 2.17%; Belgium (franc) .0194; Denmark (kroner) .1405; France (franc) .00197; Germany (d. mark) .2310; India (rupee) .2040; Italy (lira) .0016; Mexico (peso) .0774; Netherlands (guilder) .2560; New Zealand (pound) 2.70%; Norway (kroner) .1360; Sweden (kronor) .1865; Switzerland (franc) .2230; Union of South Africa (pound) 2.71%; sterling in Canada, 2.70%-2.71%; sterling in New York, 2.81%-2.81%; U.S. dollars in Canada, 3%-3% discount.

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# Editorial

## A SALUTE TO THE S.I.C.A.

THE SOCIETY OF INDUSTRIAL and Cost Accountants of Canada is holding its 38th Cost and Management Conference at St. Andrews, N.B., June 29 to July 1. As usual, the participants will include a large number of chartered accountants. Members of our Institute have always been actively associated with the affairs of the S.I.C.A., but it is extremely doubtful that the extent of their contribution to the Society's formation and development is fully realized.

The Society was formed in 1920 by a group of chartered accountants who, in the words of George Edwards the first president, recognized that it would open up "a field of legitimate endeavour not hitherto covered by either the Institutes of Chartered Accountants or the various existing media for the preparation of young men for industry". The nine incorporators, each chosen to represent a Provincial Institute, included George E. Winter of Vancouver, then president of the Dominion Association of Chartered Accountants, and two future presidents of that organization, J. B. Sutherland of Calgary and G. C. Rooke of Regina. In all there have been nine chartered accountants who have attained the S.I.C.A. presidency, including the present incumbent, Thomas B. Milne of Winnipeg.

In the history of the Society's provincial development a similar pattern is evident. Authority to grant the use of the qualifying designation R.I.A. was first sought in 1940. By 1950, provincial societies with this power were incorporated in all ten provinces, and in each instance chartered accountants provided valuable assistance and were among the original members.

From its inception the Society has devoted its major effort to the task of providing young men in industry and finance with education in accountancy. Today, a student enrolment of 4,800 indicates the widespread demand for its program. Educational policy is determined by a Coordinating Educational Committee composed of provincial representatives, and examination standards are established by an Examination Board. Instruction is provided by correspondence and evening lectures, and classes are conducted in 22 universities from St. John's to Victoria. The Society has made a valuable contribution to Canadian accounting literature by initiating Canadian adaptations of important American textbooks. The Society's services include a monthly journal, *Cost and Management*, a series of executive develop-

ment seminars and assistance with local chapter meetings. A special committee is presently considering the field of post-graduate studies.

This brief outline suggests that the Society has much to be proud of in its accomplishments to date. Those chartered accountants who established it in 1920 acted with enlightened self-interest, and the Society's record has justified their efforts. All accountants have a stake in the level of accounting knowledge which prevails in the business community, and the Society's role in raising this level merits general appreciation. As it approaches its 40th anniversary many chartered accountants will continue to take an active part in its affairs, and the anticipated growth of Canada's industrial economy will provide an important challenge in the years that lie ahead.

### AMERICAN INSTITUTE NEW RESEARCH PROGRAM

THE GOVERNING COUNCIL of the American Institute of Certified Public Accountants voted at their spring meeting to expand their accounting research program to narrow the inconsistencies in financial reporting. In making the announcement, Louis H. Penney, president of the Institute, said that generally accepted accounting principles at this time are not a clearly defined, comprehensive set of rules and that there are some areas in which the use of alternative but equally acceptable principles or procedures could result in widely varying reports of net income or earnings-per-share. These are the areas that are to receive top priority in the new research program which it is estimated may cost \$250,000 a year.

Mr. Penney said that the principal products the new program will be a series of studies prepared by a staff of AICPA researchers and recommendations on generally accepted accounting principles by an eighteen-man Accounting Principles Board made up of Institute members. Industry, stock exchanges, governmental agencies, various accounting groups and other interested organizations will be given ample opportunity to present their views. The published studies will give pro and con arguments on controversial points, offer conclusions and where possible illustrate the applications of the principles.

Following publication, the study will be reviewed by the newly created Accounting Principles Board. If two-thirds of the Board members agree with the findings, the Board will then issue a statement which it is expected would be regarded as an authoritative expression of the application of generally accepted accounting principles to the problems under study. Mr. Penney pointed out that the Institute would rely on persuasion rather than compulsion to encourage adoption of some of its more controversial pronouncements.

The task which the American Institute has set for itself will be watched with keen interest by chartered accountants in this country where the same basic problems exist.



## Vancouver — 57th Annual Meeting

VANCOUVER is known as the Playground of the Pacific Northwest — a city that offers all desirable amenities with a backdrop of fjords, canyons and mountains. It is a city of contrasts that reveals evidence of frontier days intermixed with the atmosphere of cosmopolitan cities the world over. This is the city that is Canada's third in population, second in area and C.I.C.A. choice for the site of its 1959 annual conference.

At the Hotel Vancouver on Monday morning, September 14, the opening ceremonies and presidential report by John L. Helliwell will precede an address by W. S. Owen, Q.C., president of the Canadian Bar Association. The annual general meeting will then take place, followed by an informal luncheon. "Problems of Recruitment" will be discussed in the early part of Monday afternoon at a plenary panel

discussion under the leadership of W. I. Hetherington of Toronto. Highlight of this particular session is expected to be the first official showing of the new C.I.C.A. recruitment film. The day's final session, chaired by F. T. Denis of Montreal, will deal with post-graduate education for chartered accountants in Canada and will include a review of recent developments in the U.S. by Louis Penney, president of the American Institute of Certified Public Accountants. A paper on what other Canadian professions have done will be given by E. Michael Howarth, C.I.C.A. executive secretary, and L. G. Macpherson, director of the School of Commerce and Administration at Queen's University and formerly C.I.C.A. research director, will present a paper on the challenge to the C.I.C.A. in this field.

Tuesday morning's sessions will also

be held at the Hotel Vancouver and, as innovated and proved so popular last year, will provide the opportunity for members to pursue a fairly concentrated study program over the second and third days of the conference. Accounting and auditing problems, taxation and management accounting are the topics planned for these short-term courses. Tuesday's speakers include James W. Kerr, president of Trans-Canada Pipe Lines Limited, R. B. Taylor, secretary of the Steel Co. of Canada, G. H. Cowperthwaite of Peat, Marwick, Mitchell & Co. of Toronto and Alex G. Rankin, vice-president (finance) and secretary of B.C. Forest Products Limited. Luncheon in the main dining-room of the hotel will mark the end of that day's technical sessions.

Almost by tradition, the Wednesday technical sessions take place on a university campus. This year, the profession is especially fortunate in being invited to use the beautiful campus of the University of British Columbia. The morning schedule offers a number of discussion groups on specific matters arising from the previous day's papers. Following Wednesday's luncheon, Dr. N. A. M. Mackenzie, president of the University, will deliver an address that will mark the official end of the conference technical sessions.

One glance at this year's social program reveals a deft combination of sea, sunshine, scenery and sports. The opening reception will be held at H.M.C.S. Discovery, and on Tuesday night, a moonlight cruise on Howe Sound is planned with dinner and dancing on board. Weather statistics are very much in favour of an abundance of sunshine for the free afternoon on Tuesday, and either Vancouver's many beautiful beaches or golf courses are expected to attract most of

those attending the conference. Monday evening has purposely been left free to afford visitors the opportunity of sampling Vancouver's wide range of entertainment, among which are Chinatown and a Vancouver-Calgary football game at the famous Empire Stadium. With the same emphasis on warmth and informality that proved so popular in Montreal last year, the conference will end with a cabaret style dinner-dance at the Hotel Vancouver.

Special activities for the ladies will include a scenic tour through the mountains with a stop for luncheon at the Harrison Hot Springs Hotel. Their program also includes a coffee party and an "accessories" fashion show at Canyon Gardens, as well as arrangements for golf and shopping excursions.

There is so much to see in Vancouver and in other parts of British Columbia that many members and their wives are expected to combine their visit to the conference with a vacation. The visitor has his choice of proceeding eastward through the Fraser Valley to the sunny Okanagan Valley, with its fruit orchards and rolling hills, or to the Kootenay country famed for mining, mountains and 100-mile lakes where fishing for trout and salmon is unexcelled. A further attraction is a trip to Victoria or a cruise up the coast to see the fjords. Detailed tourist information about these and many other trips can be obtained from the Greater Vancouver Tourist Association, 596 West Georgia Street, Vancouver.

In September, members and their wives can look forward to discovering something different around every corner in Vancouver — scenery, history, shops, restaurants, and, most important of all, the 1959 C.I.C.A. annual conference.

# Sales, Production and Financial Planning

WILLIAM O. TWAITS

PLANNING WITHIN an organization or enterprise is really not divisible by functions. From a practical standpoint, it is obviously impossible to divorce sales planning from production or financial planning because all are interdependent and must be closely integrated. Consequently, what we are really dealing with is corporate planning, in the broadest sense, although relative emphasis between sales, production and finance will vary with the type of industry, the size of the corporate unit and its financial condition.

## A Tactical Program

Planning, in common terminology, can be interpreted to mean a rigid course of action. "Corporate planning", on the contrary, must represent a tactical program, capable of varying with changing conditions and recognizing the breadth of individual responsibilities within a given company. In this sense, corporate planning is a relatively modern phenomenon in most industries, although, by necessity, certain types of industry have had to develop techniques much in advance of others. The current emphasis on planning, or forward programming, reflects underlying changes both in the economy and in

the mechanics of the modern enterprise, which must be recognized by the student or manager interested in this subject.

Three factors might be mentioned, all of which tend to overlap:

1. The increasing investment, per sales unit, accompanying more complicated manufacturing operations, the trend toward automation and the economics of large-scale production. High fixed investment costs mean high break-even operating costs and thus great pressure toward near-capacity operation. In other words, the plant must be utilized, as fully as possible, and many industries today can afford only a small tolerance in unused capacity without incurring an operating deficit.
2. Along with the high fixed investment charges is the growing inflexibility of other items of expense, formerly considered as variable. For instance, the operation of a machine or plant requires a certain labour force, regardless of whether the machine is operating at 50% or 100% capacity, and retention of a highly-skilled labour force is a relatively fixed cost. Parenthetically, incremental costs

for additional output are relatively small, as control of so-called "variable" costs in the classic sense is practical only over a relatively long period.

3. The necessity of a continuing input of capital into most industries, because depreciation generates insufficient funds for replacement and because working capital requirements generally increase with the trend in credit sales, mechanization, obsolescence, etc.

The foregoing factors can be expanded considerably, but they all point to the fact that, in most enterprises today, capital requirements, both fixed and working, must be geared to relatively long-term programs, looking to efficient utilization of shareholders' investment with all that this implies. The modern enterprise cannot be easily, or economically, started up and shut down to meet peak demand-and-supply conditions; it cannot depend on the vagaries of spot or short-term financing. In other words, the corporate viewpoint has, of necessity, had to be extended. Its operations must be envisaged over a period of time in the form of planning in all phases.

### Sales Planning

It is axiomatic that the end point of all planning is "sales" performance, and it may be said that sales planning is the starting point and the basis for production and financial planning. Sales planning, of course, can range from simple extrapolations of historical trends through to complicated forecasts involving correlation with population growth, G.N.P. and many other factors.

Marketing research into consumer buying habits and motivation plays an

increasingly important part, both as to the planning of regular sales programs and the development of new or substitute products. This is particularly true in the consumer goods industries where new products and quality appeal are perhaps the most significant sales factors in postwar development. Thus it is essential not only to consider one's own product in the forward sales program, but possible competitor developments, both within and without the industry. This necessarily introduces an estimate of price trends and the ability of substitute products to enter the market. All of these items will vary according to the specific industry, and generalization is not possible. However, whether it requires a marketing research department in a large organization, or individual conception on the part of a sales manager in a small organization, all the foregoing elements must be considered.

The forward sales program which will emerge must represent a balance of the following factors:

1. An assessment of the company's competitive strength in the total market, or demand outlook, versus other suppliers and substitute products.
2. A recognition of the lead time necessary to provide a given sales volume. In many industries, a period of two to three years is required from conception to completion of the equipment necessary to produce a given product or products.
3. A clear understanding of the company's financial resources and a reconciliation of the working capital requirements with the projected sales program.

Of these three factors, items 1 and

3 tend to receive insufficient attention. The enthusiasm of the sales organization can tend to obscure realism in regard to competitive strength and the financial ability of the company. Accordingly, while sales planning may be the starting point, it cannot be done by itself but only in conjunction with all other functions and with equal consideration of the three factors mentioned above.

Forward programming or planning of this type obviously cannot be prepared in absolute or fixed terms, particularly where periods in excess of a few months are involved, and/or where large cash commitments must be incurred ahead of the product sale. As a tactical program, the paramount consideration of the corporate plan is flexibility, that is the ability to make a running correction as new conditions develop. In other words, continuous forecasting and continuous correction are necessary and inevitable. This is done in many ways, the simplest of which is to carry a short-term program of a year or less, which is subject to monthly or bi-monthly correction, within a longer term program of three to five years, modified chiefly on trends. Again, the length of supply lines, the necessity of forward cash commitments and many other factors will govern the technique.

### Sales Policy

In all the foregoing, any reference to sales "policy" has been deliberately omitted, although it seems that the theorists prefer to start from this point. It may be that in an isolated, or specialty market, a policy with respect to sales is relatively easy to determine. It may also be that the term "sales policy", in itself, presents a

problem in semantics. In any event, in a competitive market, sales policy in its ordinary sense would seem to have little or no place. In fact, it may simply be a reflection of the lack of logical, cohesive planning.

Sales policy, insofar as it represents investment and earnings objectives, and so on, implies an ability to pre-determine sales by a declaration of intention which few, if any, industries are in a position to make. On the contrary, as long as there is a free flow of investment capital, and no artificial restrictions on a market, then sales policy must, of necessity, be a matter of current decision. It is worth while repeating that this presumes a condition where the market is not artificially regulated and where there is a free flow of entrepreneur capital. Any interference to either or both of these leads to an artificial market.

If it is not possible to define sales policy, except at a given moment, it is equally true that there must be some objectives or targets to which all efforts in the corporate organization are devoted. Profit must obviously be the forward planning objective, even though this can only be determined in a qualitative, rather than a quantitative sense. In fact, the corporation can only demonstrate its efficiency and its economic usefulness in terms of earnings. Therefore, everyone in an enterprise involved in planning must have a clear understanding of the profit incentive. The exact level of this profit depends on supply-and-demand conditions, the flow of capital into the industry and a host of short and long-range factors. For our purposes, the profit incentive may be divided two ways, viz.:

1. In the so-called trading operation, depending chiefly on short-term

capital, sales planning (sales policy) must be governed and reconciled, almost on a day-to-day basis, by turnover or inventory movement. The simplest measure, in this case, is earnings related to the sales dollar, which, in turn, reflects a gross margin within which the enterprise must operate.

2. Manufacturing, or similar enterprises, employing long-term fixed capital, must govern sales planning through longer cycles of capital availability and product demand changes. In this case, return on capital employed and on fixed investment is the main objective. For example, in such an industry, capital equipment must have alternative uses and the flexibility to operate through a series of demand cycles in individual products.

### Role of Communications

Since enterprises range from one or two individuals to those employing thousands of people, and since the degrees of responsibility in individual hands must vary widely with respect to day-to-day decisions, the communications system is of fundamental importance. The number of people to be informed increases almost geometrically with the size of an enterprise. All these people must have a clear idea of the corporate position, its objectives and its problems in order to implement the planning program through their daily decisions. Because they are human and because communications are imperfect, errors and deviations are bound to occur. Therefore, in the planning program it is inherent to have a control procedure to measure performance, not just in terms of sales or earnings, but with

adequate analytical data to show the area and cause of deviation.

It is appropriate to summarize at this point:

1. Forward sales planning, or programming, underlies production and financial planning, although all three must be done concurrently.
2. Flexibility is paramount in a tactical program, with clearly understood but not arbitrary objectives as to the corporation's profit targets.
3. The system must be one in which many individuals can match their daily decisions to the overall pattern.
4. There must be means of continuously measuring performance and deviations.

### Production Planning

Production, or supply planning, is chiefly a matter of technique, although this may be extremely complicated according to the industry or the product. In most industries, production schedules — including sequence of operating steps, inventory control, and equipment changes and additions — can be formalized to a considerable degree, at any rate to a much greater degree than the sales program. The increasing use of computers to permit quick analysis of alternative types of production programs, in order to optimize all cost factors, reflects the ability to measure the variables with considerable accuracy.

In essence, production planning means the most efficient utilization of manpower and facilities. In practice, this may range from a traffic control centre to a large production control department, concerning itself with every phase from raw material to

warehousing. In this sense, the production plan includes time study, standardized operations, maintenance schedules and a host of factors. Whatever the organization form, the objective of production planning and production control is to minimize costs, and, assuming that all the necessary technical skills are available, then the real problem is liaison with sales.

Regardless of the industry, the final point of sale, or disposal of the end product, takes place a long distance from the original point of manufacture and a considerable time after manufacture. Sales orders, which are the first indication of a sale, are the producing unit's easiest and quickest measure for basing its schedules. But sales orders do not necessarily represent firm customer demand or use. Furthermore, they may vary seasonally, and for other reasons which are incompatible with economic production schedules.

Accordingly, in most industries, particularly in the consumer goods field, it is necessary to set up a mechanism which will link actual sales flow to plant and field inventory changes and these, in turn, to current production schedules in a continuous program of adjustment. These adjustments must be measurable against the short-term corporate program and provide sufficient data for management analysis.

From a practical standpoint, this is probably the most difficult procedure in corporate programming and can involve a very extensive and complicated system. Techniques must be designed to fit the company; indeed, generalization is dangerous because geographical extent of the market, the variety of products and the degree of supply protection will all affect the

type of system required. This is basically a problem of communications, the objective being to provide current and accurate information to the appropriate level of management which is charged with the responsibility of taking action.

### Financial Planning

In all the foregoing, the procedures primarily relate to operating management, although it is obvious that the financial program is involved and affected at every step. However, there are some differences. The current operating decisions are made within the framework of the short-term operating program, but sales and production management are, and correctly so, more concerned with longer cycles with respect to equipment utilization, replacement and/or expansion. On the other hand, those charged with financial planning are concerned not only with the company's operation and its results, but with outside conditions governing money availability. In this sense, short-term considerations are of more immediate concern, and financial management is devoted chiefly to this within the longer-term outlook for new capital needs and capital structure.

Accordingly, financial planning, in the short term, is essentially one of managing working capital to ensure that the available liquid resources of the company move through the cycle from purchases to sales and collections with the least delay and with the most effective use at all times. This involves the employment of short-term capital in every sense from inventory changes to purchasing of commercial paper.

The longer-term problem is one of

tailoring the capital structure to meet the changing requirements of the company, as its business expands or takes on new geographical shape. A primary consideration is to preserve financial flexibility, which will permit utilizing available sources of capital, in the most effective way, without endangering the company's freedom of action and choice in regard to ultimate permanent-type financing. In any event, a basic prerequisite is an estimate of the cash flow through the company under the conditions

contemplated by sales and production programs.

Since this is a changing picture, there must be a semi-continuous reconciliation of cash revenues against cash requirements, both for operating and capital purposes. The cash flow system may have seasonal or cyclical variations but, with allowance for these factors, it forms a basis or pattern for estimating a longer term ahead, in order to take advantage of the most favourable conditions for major financing operations.

### Complexity of Auditor's Opinion

The independent auditor's opinion is complex not only because he has a large number of subsidiary judgments to make, but because the subsidiary propositions to which these judgments relate vary in nature, in significance, and in complexity. Some of them are almost completely quantitative, such as the amount of cash. Others are qualitative — for example, the disclosure or non-disclosure of a contingency. A great many, such as determining the appropriateness of the amount of inventory or receivables, have both quantitative and qualitative aspects. These propositions include both an amount and implications as to usefulness or collectibility, either of which may be crucial in influencing judgments as to the acceptability of the proposition. The variability of these propositions with respect to significance is the ever-present problem of materiality, and it is easy to see that some are much more important than others. Thus, it is never just a matter of the number of propositions judged acceptable or unacceptable. Propositions must be evaluated as to materiality as well as acceptability.

We can readily agree, also, that some are more complex than others. The assertion as to the amount of notes payable is generally much simpler than the assertion as to the amount of surplus or federal income tax payable. These latter rely upon many other propositions, some of which themselves may be of substantial complexity.

Thus, in forming his professional opinion on financial statements, an independent auditor must somehow deal with a substantial number of widely varying propositions. He must make countless subsidiary judgments; then he must evaluate these, balancing one against another, if necessary; finally he forms an overall or composite opinion based on all his preliminary judgments.

— R. K. Mautz, "Evidence, Judgment, and the Auditor's Opinion", *The Journal of Accountancy*, April 1959.

# Contrasts in United Kingdom and Canadian Annual Reports

STANLEY A. SENN, C.A.

COMPANY LAW in Britain and Canada is very similar; however, some interesting differences are reflected in the annual reports of public and private companies in both countries. Concerning these differences, the Companies Acts referred to are: (1) The British 1948 Act, (2) The Companies Act (Canada), 1934, and (3) The Ontario Corporations Act 1953. The latter has been chosen because it is the most modern of the provincial Companies Acts and therefore closest in content to the British one; it is incidentally almost 25 years since the Companies Act became law, and some of the other provincial Acts are even older.

## Balance Sheet

Under the eighth schedule of the British Act it is stated that definite main heading classifications must be used on the balance sheet.

The Cohen Committee was set up to overhaul the old British 1929 Companies Act; its recommendations were largely incorporated in the 1948 Act which superseded the 1929 Act. It further recommended that certain items should likewise be included under the main heading classifications to conform to good current practice.

For example, current assets include the customary items, namely, cash, receivables, and inventories, and in addition are shown prepaid expenses and deferred charges. The two latter items are generally considered to be current. In Canada, there is a division of opinion, and they are frequently shown under a separate classification. Consequently, in the United Kingdom there is perhaps more uniformity and consistency in balance sheet reporting, because the usual items included therein are classified in a predetermined fixed position. In Canada, under the various Companies Acts, there are definite items that have to be shown separately, but there is no provision for balance sheet classification, although good accounting practice demands a similar approach.

It is interesting to note that in the British balance sheet, the liabilities are shown on the left side and the assets on the right; also the items comprising each side are in reverse order to the Canadian presentation. The origins of the "reverse side" British balance sheet are lost in the mists of time, but opinion has it that it was produced as a balancing document to all the ledger balances. British companies have recently shown a marked

tendency to depart from the traditional balance sheet to one presented in running statement form.

For the future, when presentation and content of annual financial statements may be more uniform on a world-wide basis, it is quite probable that a narrative statement of financial position will be the accepted practice.

### Reserves and Provisions

Under the British Act, reserves and provisions are separated; the latter is either shown under its own separate classification or included under current liabilities. This is because the difference between a reserve and a provision is defined as follows:

A provision is an amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy. Examples of this definition used in current British practice are:

1. Provision for doubtful debts.
2. Provision for depreciation of fixed assets.
3. Provision for current income tax.

A reserve shall not include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability.

Examples of this definition used in current British practice are:

1. Reserve for contingencies.
2. General reserve.
3. Reserve for replacement of fixed assets. (Over cost of present assets in use. Virtually, excess depreciation.)

In Canada until the last few years, the term "reserve" was used in a

number of widely different senses for any amount set aside out of profit; this led to misunderstanding of this item in the financial statements. The Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants recognized the seriousness of the situation, and consequently issued Bulletin No. 9 in January 1953 which included their recommendations for clarification. These were included in the Ontario Act, but there is no definite directive supporting the bulletin in any of the other Canadian Companies Acts.

### Profit and Loss Statement

Under both the British and Canadian Acts, it is only necessary to show the operating profit as the commencing figure in the income statement. This precludes showing sales, cost of sales and various operating expenses in a published report; British companies frequently take advantage of this provision because it prevents competitors obtaining this useful data. In Canada, to promote more general acceptance of disclosing the above items, the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants, suggested first in Bulletin No. 1, and more recently in Bulletin No. 14, that accountants in Canada "should encourage such disclosures in financial statements".

In the British Act, there is the requirement that income from investments be split between (1) trade investments, (2) subsidiary companies and (3) other investment income. Under the Ontario Act the split is between (1) subsidiary companies which are not consolidated, (2) affiliated companies other than subsidiaries, and (3) other investment income. Under the Companies Act

(Canada) no split is required and it falls short of good accounting practice on this score. As regards directors' remuneration, the British Act requires the following to be shown separately: (1) fees, (2) salaries, (3) pensions, (4) other emoluments. This provides shareholders with a complete picture of the benefits accorded the directors managing the business. Both the Ontario Act and the Companies Act (Canada) require the inclusion of the aforementioned items, but only *in toto*. However, the Ontario Act requires only the total remuneration paid to directors in their capacity as members of the board of directors to be included. A further difference arises re the auditor's remuneration. If it has not been fixed by the shareholders in general meeting, the British Act calls for separate disclosure in the income statement; there is no such requirement in any of the Canadian Acts.

An interesting item included in the British 1948 Act was the requirement that the profit and loss account disclose the aggregate amount of the dividends paid *and proposed*. This latter item was an entirely new feature calling for the profit and loss statement, and consequently the balance sheet, to show a dividend which might never in theory be declared. It is believed that this innovation materialized because in the United Kingdom, (except where specifically provided that the directors may declare a dividend), the articles (by-laws) of a company generally empower it to declare a dividend in general meeting. The power is usually subject to a proposal of recommendation by the directors that a dividend be declared. Thus, the dividend would not be declared until the an-

nual meeting, when the company's annual financial statements are presented for approval, with the result that dividends proposed are included in the company's annual financial statements prior to declaration.

### Consolidated Statements

In Britain, the presentation of consolidated statements is supplementary to the regular annual report, with the result that under the British Act every holding company is required to submit both group accounts and unconsolidated statements. In Canada consolidated statements are gradually replacing unconsolidated statements as the prime method of financial reporting. An ever increasing number of parent companies are adopting the practice of preparing their annual financial reports on a consolidated basis and including only these statements in their published annual reports.

While consolidated accounts are necessary for providing an overall picture of the operations of a group of companies, they have certain limitations. Shareholders are unable to discern the progress of the parent company, the group accounts may show a profit, when in fact, the parent company made a loss. Neither is it possible to distinguish the assets and liabilities of the parent company from the rest of the group. This fails to show what bondholders and creditors are primarily interested in, namely, the parent company's liabilities. Therefore, consolidated accounts by themselves can present a distorted picture. The directors' report should present all the facts concisely but they sometimes neglect to do this. In Canada, presentation of only the consolidated statements in the annual financial report of a parent company

and its subsidiaries could be supplemented by the statements of the parent company.

### Comparative Figures

Under the British Act it is compulsory to show comparative figures on all financial statements of public and private companies. This is an advantage which facilitates comparison of the current year's figures with those of the preceding year, to determine the progress of a company without having to rely on summarizations of the year's results made in the director's report. However, it could be that business conditions in one year are totally dissimilar to the preceding year; such an incidence should be noted in the directors' report. Canadian companies are not compelled to show comparative figures in their annual reports, and hence the practice is less frequent but is increasing each year; if their inclusion were to become compulsory, it would result in a more comprehensive disclosure of information to the shareholders, which should be the aim of every progressive company.

Under the ninth schedule of the British Act which includes matters to be expressly stated in the auditor's report, there is the requirement that the auditor report whether in his opinion proper books of account have been kept by the company so far as appears from his examination of these books. This caused considerable comments among accountants in Britain; for the first time the company's auditor had to decide whether proper books of account had been kept by the company. The Ontario Act has a similar requirement, but there is no such provision in the Companies Act (Canada).

### Directors' Retirement

There is a provision in the British Act which requires that when a director of a company reaches the age of 70, he must retire at the conclusion of the next annual general meeting; he may remain in office only if the company at that time votes by majority for him to continue. Notice of such a situation must be shown separately on the agenda of the company to be discussed at the general meeting, and is usually commented on in the directors' report. Thereafter, at the next annual general meeting the same procedure must follow until the director is eventually retired. This puts the responsibility of determining the fitness for holding office upon the shareholders. When an older director is retired in the above manner, youth, vigour and new ideas are introduced on to a board, and there is little chance of age hindering progress. The Canadian shareholder is not allowed this privilege, as there is no similar provision in any of the Companies Acts.

### Consolidation of Acts in Canada

If all the provincial Companies Acts were eliminated as such, with their most salient features incorporated into a new Canadian Companies Act, then it would seem that company administration would be both simplified and unified. The new Act would supersede the existing 1934 Act and be used throughout Canada. All present companies could then be administered, and future companies incorporated, under the same Act. Such a consolidation is not possible under the present constitutional system, but each provincial Act could be repealed and the new Canadian Companies Act substituted as a new

provincial Act by each province. Then the Canadian and all provincial Acts would be similar in content. A federal-provincial committee has met to consider the problem of uniform Companies Acts. In the United Kingdom, which consists of three separate countries, (England and Wales are one legal entity), there is only one Companies Act, under which all companies are effectively administered. Admittedly, the act is quite voluminous by Canadian standards, but uniformity is established in incorporation and administration procedure.

### Annual Report Presentation

Canadian presentation of the annual report is markedly superior to the average presentation in the United Kingdom. The difference is quite striking; more general material and information is included; and the result is an easily understandable and highly readable document, which is much more attractive to the shareholder. The average British counterpart ap-

pears drab, dry, and uninteresting in contrast, and is primarily financial in content. There is little attempt made to arrest the shareholders' interest by presenting any additional data. However, in the last few years the larger corporations have shown quite an improvement in this respect with the institution of annual awards for the best presentation. Perhaps increased competition will result in a more favourable comparison for the future.

### Conclusion

The annual financial report of a company should include the maximum of pertinent information for the benefit of the shareholders. It is therefore reassuring to see that today the tendency is towards this goal, and is undoubtedly encouraged by the Companies Acts. It is possible that in the near future a universal form of annual financial reporting will be adopted which, allied with quarterly statement presentation, will put the annual report in an utopian category.

### Technical Jargon

A perfect illustration of the dangers of professional jargon occurred in 1947 at a meeting called to consider the winding up of a public company which by its nature attracted a large number of women shareholders, some of them elderly. The chairman came to the principal item on the agenda and put the proposition to the meeting, and from the immediate reaction it seemed certain that the resolution would be carried almost unanimously. However, the chairman was asked to clarify the motion so that all would understand clearly what they were doing. He explained that the notice convening the meeting set out the situation clearly which was that the company was to be "wound up". Before he could proceed further a dear old lady in the front row rose to her feet, put her hand in the air and said, "Yes, yes, wind it up and make it go." The resolution was lost and the company carried on.

— E. Stanley Owens, F.A.S.A. to the May 1958 convention of the Australian Society of Accountants

# The Budget: Looking

THE ART OF ACCOUNTING developed largely out of an attempt to record past events, and perhaps this explains why it is only in comparatively recent years that the accountant has ever looked anywhere but over his shoulder. Even today, only a relatively small number of accountants concern themselves with what is going to happen tomorrow and the effect that tomorrow's events will have. This is unfortunate; accountants are accused by non-accountants of being mere "scorekeepers", yet they neglect the budgeting technique and miss the opportunity not only to look forward in an organized and methodical manner, but also to measure future performance against standards which take into account many factors not applicable to previous periods.

The meaning of budgeting has expanded so quickly in the post-war era that some dictionaries have been unable to keep up with it. One dictionary defines it simply as "the amount of money which can be spent", ignoring completely the planning of income which is so much a part of modern budgeting. In brief, the present day concept of budgeting simply means that a company should decide where it wants to go, should period-

ically evaluate its progress and, if not satisfied, should do something about it. This method of management control presupposes the establishment of standards and aims at fixing responsibility for performance. It differs materially from the older concept of comparing actual results for different time periods.

## Preliminary Requirements

A successful budget requires a solid foundation, and there is no point in starting unless this foundation is laid. First of all, the general manager must be convinced of the need for a budget and prepared to enlist the support of the other senior officials of the company. When a budget begins, it will reach down and affect all the key people in a company; hence their cooperation is essential. Many budgets have died at birth because the controller neglected this. He assumed that budgeting was essentially an accounting function and failed to get the support of his general manager.

A second preliminary to good budgeting is a logically arranged company organization and a clear definition of responsibilities. Budgeting not only implies a thoughtful and detailed look into the future but also means that

# in a New Direction

ROBERT H. CRANDALL, C.A.

differences between budget and actual will be looked into and evaluated, and that action will be taken on them. To make this possible, a clear definition of duties is essential, and so is a clear-cut line of authority.

A final requirement is that the accounting department of the company should be in a position to withstand the extra demands which budgets will impose. Sometimes interim financial statements are not reliable, and this problem must be faced when budgeting is being considered. Even when the information is reliable, it may not be produced in a form which is suitable for budget purposes. Since budgeting involves the assigning of responsibility for performance to specific individuals, the accounting system must be capable of analyzing results accordingly. For example, this usually means that expenses which are analyzed according to their nature, such as wages or rent, must again be subdivided by the person responsible for incurring them.

Staffing and equipment requirements of the accounting department should also be evaluated. If an accounting department is already late in producing reports or is chronically pressed for time, it must solve this

problem first before the extra work of budgets can be considered.

Once these conditions have been met, however, it is time to implement budgeting.

## Review of Present Position and Future Objectives

Before getting into the necessary detail of budgeting, time should be taken to assess the position of the company in relation to its competitors, and to do some thinking about where the company should be going. Strictly speaking, this is not budgeting but planning, and it will not be discussed in detail here. However, it is so much a part of the same package that it should be mentioned. Technological and other changes are making a great impact, and one has only to look at the military aircraft industry to realize that the man who is thinking about what his company might be manufacturing five years hence could easily turn out to be the one making the most important contribution to the whole organization.

After a good look at the company's present position and some deliberate thinking about its future direction, the next step is to plan the sales budget.

### The Sales Budget

No accountant should fool himself by thinking that he is the kingpin in the preparation of the sales budget, because he is not. The sales budget is the end result of an examination by the firm's marketing group of the kinds and amounts of goods that the company can be expected to sell after taking into consideration market demands, past performance, profitability of different products and plant capacity.

Nevertheless, because the sales budget is so vital to the whole operation, the accountant should know something about it and, most important, he should have a fair idea when someone else is talking nonsense about it. In other words, the accountant should know what his next move is when someone says "Our business is fairly steady, and we pretty well know from month to month what our sales volume will be", or "Anyone really familiar with our business wouldn't try to make us guess what we're going to sell next year".

The flaw in the statements just quoted is that they miss one of the most important points about sales budgeting and they distort another. They ignore the fact that one of the most important contributions of sales budgeting is that it forms the basis for a coherent and detailed examination of the company's sales program. This in itself is enough to make the preparation of most sales budgets worthwhile. Such statements also distort the importance of accuracy in predicting what anticipated sales results will be. While accurate forecasts are desirable, sales budgeting is not in the nature of a guessing game, and deviations that develop between actual and budgeted results are nothing to be

ashamed of if the reasons for the important variances can be established. Searching out the reasons for variances not only aids in the preparation of a better budget next time but may reveal facts and trends that otherwise would have gone unnoticed if no budget had been prepared.

In addition to knowing when someone else is not talking sense about sales budgeting, an accountant also should be wary of typical pitfalls. A few are described below.

#### *Sales budgets should not be prepared by the accounting department*

Sometimes, the accounting department staff make the mistake of preparing the sales budget themselves. They may not trust the sales manager to prepare a realistic budget, or the sales manager may be uncooperative, feeling that he should be out seeing customers rather than back at the office doing "paperwork".

While the accounting department does have a role to play in the preparation of the sales budget, it should be confined to those activities which it is better able to do than the sales department. These would include the preparation of basic historical information, such as an analysis of sales by-product-by-month, or sales by-territory-by-salesmen.

The accounting group should not do any actual sales forecasting. The forecast is not a mere projection of past results into the future; it is an evaluation of the anticipated results of carrying out a deliberate merchandising and selling policy.

For example, the case can be cited of a housebuilder whose sales had been climbing comfortably for several years. If a graph of these sales had been drawn and the graph extended

forward, it would have indicated, of course, even higher sales for the year to come. However, this builder had been analyzing the basic reasons why people had bought his kind of house, and he had developed the concepts of "potential demand" and "effective demand". The houses he sold were NHA homes in suburbia, and people bought them because they were under pressure to purchase larger places to keep pace with the increasing size of their families. He referred to this pressure as "potential demand", and he knew it was falling because reports from the Dominion Bureau of Statistics told him that net family formation was starting to decrease. "Effective demand" was the potential house buyers' ability to actually lay down the cash and buy the house. He knew that this was tapering off because of two items of information: available figures indicated that the number of unsold houses was rising, and his contacts in the second mortgage market indicated that an increasing number of new house purchasers were unable to meet the down-payment requirements and had to resort to second mortgages.

This builder concluded that the buoyancy had gone out of the housing market; he left it completely, and has not built another house. The year after he stopped building houses, a number of other builders wished they had done the same.

*A forecast of total monthly sales is not enough*

It is not uncommon to find a sales budget which consists merely of the expected total sales broken down by months. One cannot help feeling that this kind of budget was prepared some evening in a haze of cigarette

smoke by a couple of people who sat down with last year's sales figures and a feeling that in the coming year the sales ought to be increased by a certain percentage.

Of course, this sort of budget is useless, and the perpetrators of it would have done everyone a kindness by going home instead of working late at the office. Such a forecast is useless for several reasons: it is not a useful guide to the factory staff who want to do some planning of production, and purchase equipment and material for the following year; it indicates that the sales group have not been developing a sales program which will be putting stress on the high-profit lines; most serious of all, it shows that the sales department is not doing an adequate job of sales planning for the coming year. Sales planning should get down to the individual product line and a reasonably small geographical area if it is going to be done seriously. The sales budget should be the end result of asking such questions as "What went wrong with the product in this area last year?" "What have we done to correct the situation?" "When, and how strongly, will corrective action make itself felt?"

*Follow-up must be done carefully*

Poor follow-up of significant variances between budgeted and actual results is often a symptom that the people preparing the budget are going through the motions to keep their bank, one of their directors, or some other important person happy. Or it may mean that they have started budgeting because they hear it is fashionable, and do not really understand its significance.

Poor follow-up is the inevitable result of preparing a poor budget in the

first place. In a typical case, the sales budget was prepared by the controller because everyone else claimed to be too busy. The controller sat down and prepared a "budget" on the basis of what he thought sales would have to be if the company was going to make a profit in the following year. He therefore came up with a "target" budget rather than an "expected performance" budget. When the actual sales figures became available, it was apparent that large variances were developing between the actual and budgeted results. However, no effective investigation of the reasons for these differences could be made because the sales budget had not been based on anything tangible to start with.

#### **Illustration of Good Sales Budgeting**

Before leaving the subject of sales budgeting, it might be worthwhile describing how one rubber company prepares its annual budget for replacement tire sales.

This company starts by getting an idea of the total market demand for replacement tires in each geographical area. It does so by establishing automobile registrations by type of car in each geographical area. With this information it is relatively easy to establish how many original tires of each size are in use, and how old they are. Experience has taught it how long a tire can be expected to last, and with this information it can produce an estimate of the total expected demand for each size of tire.

Having established the total size of the market available, the company then determines the percentage of the market it expects to get. To do this it tries to evaluate the effect of new dealerships; new marketing techniques being tried in a given area, e.g. com-

pany-owned outlets; changes in customer acceptance of their brands in the area and what the competition is doing.

Its next problem is to decide when it is going to sell its product. It has daily sales reports from prior years to use as a guide, and will also try to evaluate the effect of, say, the first expected snowstorm with the resulting jump in sales of snow tires.

This budget then forms the basis of factory production plans for the coming year and, of course, is one of the main foundations for the other budgets.

#### **The Expense Budget**

The expense budget is one of the essential controls over the dollars to be spent on non-capital items in the coming period. It is the one which accountants usually think of when the term "budget" is mentioned. Some of the more important things to be kept in mind when preparing a budget of this sort are outlined below.

##### *Establish standards for the proper level of expense*

When deciding how large an expense category should be, the natural thing to do is to look back to last year to see how large it was then. This can be a useful approach, but it is not as good as a close examination of the nature of the expense as a means of determining what a reasonable level of expenditure should be.

This can be illustrated by describing a problem faced by a company which had a large office building with rooms which had to be repainted periodically. The company calculated the area to be painted in each room, decided how often a room should be painted, how fast a man should be

able to paint, and produced an estimate of the number of full time painters it would need to do the job. This not only allowed the work to be planned more carefully, but also gave a good insight into what the level of annual painting costs should be.

*Break down expenses according to the people responsible for them*

If individual employees are going to be held accountable for the expenses connected with the functions controlled by them, the accounting system must be capable of supplying expense information analyzed according to those individuals who control such expense. Expenses are traditionally analyzed according to their nature (e.g. telephone, salaries), and the need to provide expense information by individuals who incur them may be one of the chief "mechanical" problems to be faced when the budget is introduced.

Key employees should be told regularly, by means of budget reports, what their performance has been in relation to their budget. However, they should not be confused or dismayed by being told about those expenses of their department over which they have no control. For instance, it is not uncommon to find that charges for general administrative overhead are included in a departmental budget. The department head can usually do little to control this expense, and when that is the case, it is preferable to leave it off his budget entirely.

*A company installing a budget should establish what the largest expenses are, and concentrate on controlling these first*

A study was made recently of the

expense budget of a company where the biggest expenses by far were salaries and wages. Very wisely, this is where it had concentrated its attention, splitting salary and wage costs down among the supervisory staff according to those people they controlled. However, it had not set standards, and at this point was merely telling all the supervisory staff to cut their wage costs by a given percentage. This approach worked as long as there were excess staff to be eliminated, but the time would soon come — and it realized this itself — when arbitrary percentage cuts would do a great deal of damage. At that point it would have to think in terms of evaluating clerical work load on a more precise basis.

### The Cash Budget

This budget is probably the one most appreciated by the small client. Despite all the educational work of accountants, many small businessmen still think largely in terms of cash inflow and outflow, hence the cash budget is the one closest to their hearts. Unfortunately, an accurate cash budget must rely on other budgets such as the sales, expense and capital equipment budgets, and cannot be reliably prepared without them.

It is remarkable how long even medium-sized companies can ignore the need for a cash budget. An illustration of this is the company which was given a loan limit by its bank of \$200,000. At the same time, the bank indicated that henceforth a cash budget should be prepared, and that it would like a copy. For the first time, the company officials sat down and prepared a rough cash budget which indicated to them that their maximum

loan requirements for the year were going to be \$250,000, not the \$200,00 they had been limited to. Thanks to the bank, they had been forced into looking at their short-range financial future; without this prodding they would probably have been unaware of their plight until they fell into it. This case is probably not unusual; undoubtedly many other companies will find themselves in this position in the future. It is to be hoped that someone prods them into cash budgeting before this happens.

### The Follow-Up

Good follow-up is vital to good budgeting, since the budgeting process consists essentially of planning the performance expected, recording the results, and *comparing the actual results with the planned results and evaluating the reasons for variances*. There are two essential points to good follow-up. The first is the awareness that favourable variances are equally as important as unfavourable ones since they might indicate new favourable conditions which should be exploited. Secondly, it is important to make sure that explanations are provided for all important variances, and that these explanations make good sense. For instance, an explanation of an unfavourable salary variance should not be "salary expense is up

because we hired more people and raised some salaries", but "salary expense is up because we hired a third plant guard in order to put plant protection on a 24-hour basis".

Some of the questions which might be asked in a good follow-up are: *Where were we wrong? Why were we wrong? What are we going to do about it? What effect will this have on budgets of future periods?* The last question is important because it will provide some of the material for periodic budget review. At this periodic review, which should be held at least quarterly, the budget should be amended and extended in the light of known conditions. This will mean that budgets are not tied to the company's fiscal year, but are continually being extended forward.

### Conclusion

By now the impression has probably been given that budgeting is a difficult task. This is true. It is a way of managing a business, not a set of special financial statements which are dashed off annually in a couple of evenings. However, it is worthwhile hard work leading to a more organized approach to the conduct of the business. In this era of rapid change, it is an approach which many companies are finding they cannot do without.

# Long-Range Planning for Railway Revenue Accounting

LEONARD J. MILLS, O.B.E., F.C.A.

IN ANY BUSINESS, sales data is of prime importance. Senior executives need to know promptly not only what gross sales have been but what has been sold and who has bought it. This is of particular importance in the railway industry at this moment in its history. The large overall amounts, numerous customers, massive detail and widespread geographical organization make railway revenue accounting systems designed to produce such data difficult to coordinate and control. These same conditions make complex integrated and electronic data processing systems very attractive. As a result, a revolution requiring long-range planning is taking place in railway revenue accounting.

If one is to have an appreciation of the size and scope of the problems involved in the Canadian National Railways, it is necessary to keep a few statistics in mind. Some of the more important for the year 1957 are:

1. Miles of main track	25,767
2. Railway equipment:	
Locomotives	2,910
Freight equipment	121,002
Passenger equipment	3,572
3. Train miles	68,133,477
4. Freight traffic:	
Tons carried	88,880,881
Ton miles revenue freight	36,673,910,825

Revenue per ton mile	\$0.01601
Number of waybills:	
Carload	2,049,000
Less-than-carload	4,070,000

Total	6,119,000
5. Number of agents through whom revenue is reported	2,150

The C.N.R.'s operating revenues for the year 1957 were:

Freight services	\$604,932,271
Passenger services	58,035,602
Express	42,926,608
Communications	20,750,060
All other	26,521,423

Total operating revenues ..... \$753,165,964

## Main Characteristics

The main characteristics of the C.N.R. from a revenue accounting point of view are:

1. It is a very large business.
2. Its business is an accumulation of many transactions at a low revenue per unit.
3. It does its business with the public through a very large number of branches (agents) spread over a wide geographical area.
4. Like other railways it is subject to much public regulation.
5. It works through a complicated tariff structure.

6. Its most important source of revenue is the freight service.

### Freight: Biggest Source of Revenue

The C.N.R.'s passenger, express and communication services are important and large enough in volume of both transactions and total revenue to justify the concern and study which is lavished on them. However, the fact remains that freight is the big business. It is therefore intended in this article to deal only with some of the problems peculiar to freight revenue accounting.

The freight waybill is many things to many people. In the early stages of its life, it is used to make up and move trains. It is necessary, therefore, that either a copy of it or the information which it contains reach the yard office at the earliest possible moment. In addition, it provides the information necessary to:

- a) get the freight to its destination, during which time it is of interest to the freight train conductor and to the forwarding and receiving agents;
- b) record the whereabouts of every unit of freight rolling stock, that is, for car accounting and car tracing purposes;
- c) collect the amounts due from railway customers, or due to or from other railroads;
- d) provide the multitude of statistics required for administrative purposes and by regulatory bodies.

In essence the waybill is both a work order and an invoice.

The Canadian National Railways handled 6,119,000 waybills in 1957, divided as shown below.

### Decentralized and Centralized Accounting

Revenue freight accounting is done in two main areas: in the first place through some 2,150 individual agents and, in the second, in the revenue accounting department located in Montreal. From a revenue accounting point of view, all but about 100 of the agents are responsible for receiving and delivering the freight, preparing waybills and freight bills, collecting amounts due from railway customers, disposing of their surplus funds to bankers as directed, preparing monthly accounts of all their transactions and submitting these accounts to the revenue accounting department in Montreal.

The revenue accounting department in its turn does the following:

1. For the 100 largest stations, prepares a monthly account of all transactions for the agent.
2. Consolidates all agents' monthly accounts to prepare Canadian lines' revenues.
3. Audits waybills reported by destination agents against report of waybills issued by agents at points of origin.
4. Verifies rates and the mathematical accuracy of waybills.

### C.N.R. WAYBILLS, 1957

	Number	Total Value	Average Value
Carload .....	2,049,000	\$550,275,284	\$268.56
Less-than-carload .....	4,070,000	36,998,232	9.09
Total .....	6,119,000	\$587,273,516	\$ 95.98

5. Apportions revenue on shipments received from other railways between originating, intermediate and destination roads.
6. Determines that correct proportion of revenue is received by C.N.R. for all freight forwarded to other railroads.
7. Investigates and settles overcharges and under-charges on all freight transactions as a result of the audit procedures and of complaints from customers and other roads.

### Hand Operations

At the agent level, practically all freight accounting has been a manual operation. At a few of the larger stations the agent has used conventional posting machines, but little else in the way of modern accounting equipment.

This has also been the case, speaking very generally, in the revenue accounting department in Montreal, although the monthly accounts for the 100 largest stations and certain statistical reports have been prepared through the use of punch card equipment. The only office machines in extensive use, however, have been the lowly typewriter and the manually operated calculating machine.

In recent years, however, this situation in the revenue accounting department has been changing. In the near future, changes will also take place at the agent level as integrated and electronic data processing concepts are evolved.

The introduction of modern systems using complex electronic machines will abolish many routine clerical functions. It will also move much of the work which is now centralized in the revenue accounting depart-

ment back to regional accounting organizations and will transfer much of the agent's work to these regional organizations.

### Advent of IDP

There has been a revolution in accounting methods throughout the whole railway industry. Probably the most spectacular results have been achieved in the payroll area where the most advanced electronic computers are in use. This revolution is extending to revenue accounting, but is taking place more slowly by reason of the complexity of the input data and the geographical conditions referred to earlier.

In the not too distant future, new systems will result in the production of by-product tape as the waybill is typed from the bill of lading or the shipping order. From this tape the information needed will be fed to machines in the yard offices for making up trains and for transmission to receiving yards, enabling them to do advance planning relating to delivery, switching, icing, stock feeding, etc. Information will flow also from these tapes for revenue accounting, car accounting, car tracing and sales statistical data. In the C.N.R., in the early stages, punch cards will bridge the gap between the original document and the electronic machines. Punch cards will be used for customer billing and collection as well as for inter-road settlements.

It is easy to say that these things will be done. In practice, it is a great deal more difficult to make such concepts effective because of the complex administrative problems involved, not to mention the very large volume of transactions and the search for effective, well-proven equipment.

### Preparing the Waybill

In an integrated data processing system the careful preparation of the source document, i.e. the waybill, is all important. Its preparation in future is going to call for much greater care and skill than has been necessary heretofore. In the past, provided the essential data found its way onto the waybill in some form or other and the waybill was prepared quickly enough to facilitate the make-up and movement of trains, no insuperable difficulties arose.

While speedy preparation will continue to be of primary importance, more information on the waybill is going to be necessary, and it will have to be prepared more carefully and accurately. One of the great problems is that today, when more careful and accurate preparation is required, the bill or the information which it contains is needed more urgently in the yard office. This arises out of needs incidental to the great speed-up in car handling through the mechanization of yard operations and following the installation of electronically controlled "hump" yards. These problems, on the surface, seem quite simple but are, in fact, very difficult to solve. In many instances, they involve the use of many modern means of communication, including teletype, facsimile transmission and radio.

As intimated above, more information will have to go onto the waybill. At least, information will have to go on in a form acceptable to the machines used in an integrated system. This will include using code numbers for stations, shippers, consignees and commodities. Increasing needs for information are making it evident that instead of using the conventional Board of Transport Commissioners

three-digit code, it will be necessary to go into six-digit commodity codes. Waybills are being redesigned to ensure speedy preparation in the first instance, and to facilitate key-punching and the extraction of data from a by-product tape.

It follows quite naturally, also, that much experimentation is necessary with various types of equipment for the preparation of the waybill and transmitting the information it contains.

### Customers' Accounts

As will have been gathered from what has been said earlier, customers' accounts have, in the past, been prepared as a manual operation; in some cases with the aid of typewriter, and in other instances with the help of conventional posting machines.

However, in the near future it will be general for customers' accounts to be prepared through the use of by-product tape, punch cards and electronic calculators. With the large number of customers and large volume of transactions involved, it is apparent that very careful planning has to go into the changeover from manual to more complex systems that will fit into an integrated concept.

### Interline Settlements

The Canadian National Railways each month receives some 30,000 freight shipments from other railroads. The revenue involved in each shipment has to be divided between the originating, destination and intermediate roads. For less-than-carload shipments, the practice has become prevalent of making these divisions on a road-to-road basis (based on average percentages).

In the past interline divisions have

been made manually with the aid of calculating machines, and individual accounts have been prepared on typewriters or similar machines. It is becoming common now for these divisions to be made with the aid of punch cards and electronic calculators. A punch card is prepared for each interline waybill, which is matched against a master division card through an electronic calculator. The calculator makes the divisions between the various roads concerned and produces summary cards. The latter are used to prepare an individual statement for each shipment and for the summary account which goes out to each road concerned.

At the present time, the C.N.R. is making mechanical interline divisions for about 25% of its 30,000 monthly interline carload waybills, and it is anticipated that 65% of these waybills will be handled this way by the end of 1959. Since this method can only be used economically for repetitive traffic, it is anticipated that it will not be possible to mechanize more than 65% of the work in this area. Even this will involve the mechanical and/or electronic selection of the appropriate division data from about 125,000 possibilities.

#### Improved Statistical Data

As punched cards and tapes are used more and more for operating and accounting purposes, much more statistical data becomes available for administrative purposes. This includes statistics relating to traffic by stations, between given stations, by

shipper, by consignee, and by commodity and sub-commodity.

#### Simplification of Tariffs

As already indicated, the railway industry works through a complicated tariff structure. Its complexities are undoubtedly costing the industry a great deal of money and effort. This is quite generally recognized, and it can be anticipated that determined efforts will be made to simplify the tariffs with resulting economies in administrative work and vastly improved customer relations.

#### Theory and Practice

In theory, an integrated or electronic data processing system of railway revenue accounting is simplicity itself. However, in practice its development is slow and difficult because of the careful timing necessary to avoid chaos during the changeover period and the necessary integration of numerous and conflicting demands on the information being processed. The volume involved is high, and there is great complexity of the traffic movement including diversions and services en route, such as icing, stock feeding, milling-in-transit, etc.

Despite the difficulties, however, much progress has been and is being made in many individual areas across a very broad front. In the case of the C.N.R., these individual programs ultimately mesh and present an integrated procedure which will substantially increase the efficiency of the system and reduce its accounting costs.

# The Accountant and the Farmer

WALTER A. GREGORY, C.A.

CHARTERED ACCOUNTANTS, practising public accounting, can offer a valuable service to farmers by assisting them with the preparation of their financial statements and income tax returns and advising them on bookkeeping procedures and costing methods.

## Bookkeeping

These comments on bookkeeping are confined to those applicable to the average farmer. The large incorporated farm and the multiple-farm operation require more extensive accounting records.

With very few exceptions, farmers maintain records and prepare financial statements for income tax purposes only. It is common for a farmer simply to list his income and expenses from the invoices he has kept and his recollection of transactions, when he prepares his profit and loss statements for income tax returns. Apparently a large percentage of farmers are not sufficiently interested in the accurate determination of income, costs and profits, to maintain complete records. The farmer is operating a business, and the rule-of-thumb operations common in past years are no longer satisfactory. Successful farm management requires both technical knowledge and good record-keeping.

Numerous bookkeeping systems

have been developed for farmers. Some will show results of various departments, such as net income per field, or per crop grown, or from livestock. Generally, however, these systems appear to be too complicated and therefore do not appeal to the average farmer. Some outline various methods for calculating depreciation. However, the farmer must have a system satisfactory to the Taxation Division and is usually not prepared to keep two sets of fixed assets records.

Probably the most useful and needed bookkeeping system is one in which the farmer can record his receipts and disbursements simply and systematically. A columnar book with sections for receipts and disbursements should serve that purpose. The receipts section will have columns for description, cash and bank (to indicate whether amounts received were held in cash or deposited in the bank) and the various sources of income. The disbursement section will have columns for description, cash and bank (indicating whether the payments were made by cash or cheque) and types of expenses and purchases. The columns will be headed up with items common to the particular farm operation.

When the farmer desires to determine the results of the various individual operations, he can do so easily from the receipts and disbursements record. By taking the assets and liabilities from the previous year's financial statements and the current year's results from the receipts and disbursements records, the public accountant can readily prepare financial statements. Unfortunately, there are not enough qualified public accountants in all rural areas, and frequently it is necessary for the farmer to rely on the assistance of non-qualified persons, licensed and unlicensed, to prepare his financial statements.

### Analyzing the Farm Business

Proper accounting techniques will aid a farmer to measure the efficiency of his farm and will help to locate weaknesses so that he can improve his operation. The Farm Economics Branch of the Ontario Department of Agriculture has developed a "farm business analysis" form designed to locate the weakest factors in the operation of a farm. This is done by comparing results with well known standards based on the accomplishments of other farms. The causes of the weakness can be discovered and a logical program of improvement developed. A single weak factor often offsets the financial advantages of several strong factors. Improving the weakest parts of a farm operation is usually the easiest and most productive method of increasing the income of the farm. The farmer has to decide which crop can be most effectively grown in his area. He must also determine whether he is making effective use of his labour, whether the farm is adequately mechanized and whether the field and building arrangements are satisfactory. By the use of the farm busi-

ness analysis form, a farmer can greatly improve the income from his farm by making the changes that are indicated by the results of the analysis.

Farming has become an increasingly complex business. Manufacturing concerns usually know the output of a finished product that will result from a given amount of labour and raw materials. The farmer cannot be certain of the outcome when he pays out the money to get his year's production under way. As well as being able to produce efficiently, he must be a judge of markets for both his purchases and sales. Reasonable returns and efficient management have come to depend more and more on the use of records. The successful farmer not only keeps records but also looks upon them as a means of increasing his operating efficiency. Farm records and accounts help to take the uncertainty out of farming and put the facts before the owner. As in other businesses, it is difficult for him to record significant facts with a minimum of effort and yet not omit important information. However, once a suitable system is adopted, keeping records up to date should be relatively easy.

### Income Taxes

The taxation of farm income presents many interesting problems to the professional accountant. Several alternatives are open to the taxpayer, and the accountant can offer valuable service by advising as to the best choice.

Generally, the most satisfactory way to record farm income and expenses for income tax purposes is on the cash basis. Some of the tax advantages of this basis are as follows:

1. Income is taxable only when realized in cash.
2. The averaging of income makes allowance for fluctuating income. This gives the farmer most of the tax advantages of the accrual basis without its disadvantages.
3. Net income in any given year can be controlled to give the best tax advantage by making purchases or sales just prior to the year end.
4. The provisions of the Income Tax Act protect the farmer from the possibility that the value of inventories of produce or livestock on hand when he dies will be added to his income of that year. He is allowed to add one-fifth of the value of inventory at death to the income for each of the five preceding years including the year of death; or the value of such inventory can be considered income of the beneficiaries in the year in which they receive it.

The main disadvantage of the cash basis arises if the farmer wishes to cease farming and sell his crops or livestock in one year. In order to spread out his income, he may sell his farm and equipment and dispose of his inventories over several years. Alternatively, he may sell his livestock under an agreement whereby the buyer pays so much a year, secured by a chattel mortgage on the livestock, and report the annual payment as income. An item not handled on the usual cash basis is the patronage dividends from cooperatives received in the form of shares or certificates of indebtedness. These are taxable in the year when such shares or certificates are allocated to the same extent as if they had been received in cash. For these reasons, the cash basis of accounting will produce the best re-

sults for income tax purposes, except in very unusual circumstances.

The best method for computing net income for income tax purposes, however, is not necessarily the best method of computing the farm income or for analyzing the farm operations. To measure the net income correctly other factors should be considered with the cash basis, such as accounts receivable, inventories and accounts payable.

### Tax Regulations

The main income tax regulations relating to farmers are as follows:

In addition to the usual loss-carry-forward and loss-carry-backward provision of the Act, the farmer is permitted, for tax purposes, to average his income over any five consecutive years, not including years of a previous averaging period.

A farmer may choose between straight-line or diminishing-balance methods for calculating depreciation. The main advantage to the former method is that the recapture provisions of the Income Tax Act do not apply in the case of disposal of assets. This, of course, is only an advantage when the sale price or trade-in value of the depreciable asset is in excess of the depreciated value. When assets are new, this method results in lower annual charges to income than the diminishing-balance method, but in most cases this disadvantage will be more than offset by the tax saving on the disposal of depreciable assets. Straight-line depreciation requires the calculation of capital gains or losses on the disposal of assets. Once a farmer changes from the straight-line to the diminishing-balance method, he must remain on the diminishing-balance method.

A taxpayer who is engaged in the business of production of livestock or livestock products, and maintains a permanent herd of livestock for that purpose, may apply for approval of a basic herd. The basic herd is determined as the number of mature animals, or their replacements expressed in terms of mature animals, which have been acquired without the cost being charged to expense and therefore reducing taxable income. An established basic herd may be increased by the addition of mature animals when they have been acquired by (a) purchase in the current year provided no part of the cost is charged to expense, (b) gift, (c) inheritance, provided the animals were included in a basic herd of the deceased or their fair market value had been added to the income of the deceased. Actual increases may be added to the basic herd in the year in which the animals become mature, provided the fair market value of such animals is added to the income of that year. When the number of animals (expressed in terms of mature animals) on hand at the end of any fiscal period is less than the number of the established basic herd, the reduction in the basic herd is a capital recovery. To this extent the proceeds are not subject to income tax, and the established basic herd is reduced accordingly.

#### Tax Advantages

The advantages of the corporate form of organization for a farm are similar to those of other businesses. The problem of inventory of grain or livestock on the death of a farmer is greatly simplified if the farm is incorporated. Business and professional men owning farms can realize all the tax advantages of a farmer when the farm is incorporated, whereas other-

wise the farm would not be their chief source of income and they would be unable to avail themselves of such advantages.

Farmers are not required to pay monthly or quarterly instalments of tax as are other taxpayers. They are required to pay, on or before December 31 of each year, an instalment of tax equal to two-thirds of the tax payable on either the estimated taxable income of the year or the actual taxable income of the immediately preceding year.

One real income tax advantage for a farmer, compared with most other taxpayers, relates to his cost of living. Many items which salaried employees and businessmen must pay from income after tax are deductible from the taxable income of a farmer. A few of these are mortgage interest, hydro, telephone, taxes, a portion of house depreciation, cost of garage, tools, a portion of automobile operating costs and insurance on buildings.

Some taxpayers whose chief source of income is derived from sources other than farming maintain farms. When the taxpayer's chief source of income is neither (1) farming nor (2) a combination of farming and some other source, he may deduct his farming loss up to \$2,500. When a loss exceeds this amount, one-half of the excess may also be deducted, but the additional deduction may not exceed \$2,500. This provision is applicable to 1958 and subsequent taxation years. For the 1957 and previous taxation years the deductible amount was the lesser of one-half the loss or \$5,000. Deduction of capital cost allowance is permitted for 1958 and subsequent years; for the 1957 and previous taxation years no such deduction is allowed.

### Farm Cooperatives

A few farmers have organized themselves into cooperatives for purposes of collective farming. These require an audit as do all limited companies.

In reporting to the directors of a co-operative it is preferable for the auditors to present a much more detailed report than is usual with other companies. The directors depend to a great extent on the auditors to explain the make-up of the assets and liabilities and the changes therein during

the year, and the significant items affecting the net income. The auditor frequently assists the management and directors by helping them with the preparation of budgets and giving financial advice.

The importance of agriculture in our economy and the increasing competition in the farm industry has created a demand for technological progress and efficient farm management. Accountants are prepared to play their part in bringing this about.

### Income Tax in Kind

We read in a professional journal that Spanish publishers have offered to pay their income tax with books. They have proposed to the government that among them, in lieu of tax money, they should contribute 500,000 books each year to the public libraries of Spain.

The Spanish government is reported as not having replied to this offer so far. No doubt it is cogitating on the possible repercussions if it accepts the publishers' offer. Quite apart from the questions of what books would be offered . . . how many copies of the same book would be accepted, and whether the great Spanish public would in fact flock to the libraries to read the books, there would be the problem of the inevitable spread of the system.

Farmers, for example. Would they deliver their tax contributions, presumably to state institutions, alive or dead? And what of the "non-productive" professions? Would they offer their services free to the government? Any fears of redundancy in the civil service would be allayed by the complexity of operation of the tax system. The Spanish government could, of course, always refer to records of ancient Egypt where money was unknown and taxation was in kind. The treasury was then, instead of a chest, a storehouse, or rather a series of such buildings, each allocated to a particular commodity. And, after all, what is a library but a storehouse of books? Or the publishers could operate the mediaeval tithe system, offering to the government the royalties of every tenth book published, or allocating one in ten of each printing to a library. But what of the farmer whose sow had only nine piglets? Or the professional man who found that he could not attend an important meeting because it was his day for giving his services free to the government?

# Currency Exchange Convertibility

H. DUKE SCOTT

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THE SIMULTANEOUS announcements from London and Continental capitals in December 1958 of a measure of exchange convertibility, accompanied by a further devaluation of the French *franc*, are more important for the *de facto* recognition of the immense improvement in Britain's external financial position over the last few years than as a dramatic change in basic policy.

## Wartime Controls

To appreciate the situation in proper perspective, we should cast our minds back some 20 years when, at the outbreak of World War II, practically all western countries (except the United States and Switzerland), including Britain and Canada, found it necessary to instal a system of foreign exchange control in order to conserve their external assets for war purposes. The nationals and residents of these countries were restricted in the use of foreign exchange resources owned by them and denied the privilege of acquiring more for investments, travel, etc. Furthermore, it was found necessary to channel pay-

ments either in local currency or foreign exchange due to and from foreign countries.

Arising from this, the pound sterling could not officially be converted by, say, a resident of Belgium to U.S. dollars. The so-called "hard" and "soft" currencies were a result of the recognition of this non-convertibility into the supposedly more desirable currencies, of which the principal was the United States dollar. The present measure of convertibility deals *exclusively* with this matter of "channelization" by rendering the pound sterling transferable between residents of all countries. The same, of course, applies equally to other western countries which made similar announcements of "convertibility for external account".

Parenthetically, it should be remarked that the pound sterling includes for all practical purposes the currencies of the "sterling area" (which consists of all Commonwealth countries except Canada and a few other smaller countries such as Iceland, Iraq and Libya). Nonetheless each country in the sterling area still maintains its own detailed regulations, which in some cases restrict payments between other fellow-members of the sterling area. The British officielle for the sterling area is "scheduled territories", and in the case of Britain the only difference in designation with respect to payments abroad is now "scheduled territories" and "external account".

Parallel regulations are now in force in other Western European countries, including France, which made similar announcements.

## Measures of Channelization

It must be emphasized that the present measures deal only with

"channelization" and have no effect on the import and export of capital and the kindred matter of travel allowances. In short, there has been no dismantlement of the paraphernalia of foreign exchange control. There is not even complete "convertibility for foreigners" as the latter would imply the official provision of foreign exchange for the sale and export of capital assets. The word "official" is itself a confession of restrictions; only when this word disappears from the terminology of foreign exchange will there be recognition of "convertibility" both for foreigners and residents.

The basic purpose of foreign exchange control is, of course, to conserve existing reserves of foreign exchange and to ensure that future accruals will serve the national interest. Another purpose is to prevent or deter foreigners from liquidating and repatriating their assets in the country concerned. This leads inevitably to the establishment of strict rules and regulations governing all monetary transactions between residents and non-residents, including restrictions on travel. There can be no quarrel with such restrictions in time of war or economic crisis, but once the system is established it becomes difficult to drop. Fixed rates of exchange distort the pattern of trade and lead to quotas, embargoes and other artificial restrictions.

#### "Hard" v. "Soft" Currencies

One of these artificialities has been the channelling of payments and therefore imports and exports, and the distinction between "hard" and "soft" currencies. The definition of "hard" currency is simply one that is hard to get. The new move towards convertibility will blur and perhaps eliminate

the distinction between a "hard" and "soft" currency.

At the height of the period of foreign exchange restrictions during and immediately following the war, there were many types of sterling, and, converted into dollars, these were of differing values according to the softness or hardness of the local currency concerned. This confused situation was simplified a few years ago by the progressive movement from multitudinous areas to only two: "American account" and "transferable". American account sterling included Canada and a few other countries in the Western Hemisphere, and the transferable account area was composed originally of the European Payments Union countries and was later expanded to include most of the rest of the world. These two areas have now been made into one.

#### Zurich: Hub of Foreign Exchange

The inauguration of foreign exchange control by Britain in 1939 at fixed rates of exchange set by the Bank of England cut off at one stroke one of the most important and profitable activities of London bankers, namely, the dealing and arbitrage with their opposite numbers abroad in all foreign exchanges. London was undoubtedly the foreign exchange centre of the world, and trading techniques had been developed to a very high state of efficiency. The waste of this talent for almost a generation has been one of the financial tragedies of the war and post-war economic difficulties. Zurich, Switzerland, took London's place to a large extent and was well qualified to do so, both by her geographical position and the competence of her bankers. Switzerland maintained a completely free

currency with a fixed relationship to gold and U.S. dollars, and was able to deal in all the multitudinous bi-lateral exchanges.

The Western world owes a debt of gratitude to Switzerland for her competence in filling this gap and thereby fostering the exchange of goods and services between all countries. The proof of competence has been the continuance and indeed immense increase in the volume of foreign trade since 1945, although undoubtedly the direction of trade has in many respects been distorted. Presently there are distinct indications that London will regain rapidly her predominant position as the principal foreign exchange market of the world. Canada has, incidentally, played an important part in restoring normal conditions by the complete elimination of foreign exchange control and the establishment in 1950 of a floating exchange rate subject to day-to-day demand for and supply of the Canadian dollar.

### **Sterling Rates Today**

To summarize the technical position — and these remarks apply equally to the currencies of the other Western European countries who made similar announcements — there are now only two rates for sterling; one is the rate of exchange for payments to and from "external account", and the other for so-called "security" or "switch" sterling. "External account" sterling is that for all current transactions with all countries of the world, and "security" or "switch" sterling relates to capital or security transactions of non-residents.

At the end of 1958 "transferable" sterling had reached a point where it was valued in terms of dollars within a very small fraction of "American ac-

count" sterling. While the climate was of course favourable, due to Britain's vastly improved external position, it is thought that some official intervention in the market had occurred for some months before. The rate for "security" or "switch" sterling had also steadily improved to the point where the quotation was within one cent per pound of the official variety. Here, too, it is likely that some official intervention in the market, perhaps indirect, had occurred. We are therefore now left with two moves before sterling can be truly termed freely convertible: first, the merging of "security" or "switch" with "external account", which will allow free movement of capital to and from Britain, and, secondly, the lifting of restrictions on capital exports and travel by residents of sterling countries. The first of these moves may occur soon, at least in the case of Britain. (Perhaps there will be some reservation in the case of certain other members of the sterling area such as India and Pakistan.) When the first of these steps is taken, sterling will be truly convertible for non-residents for all purposes. When the second is taken, sterling will have been restored completely to its former proud position as the leading international currency of the world.

### **Position of Britain**

One is tempted to draw a comparison between Britain's position today and Canada's in 1950. While the comparison is by no means entirely valid, some lessons can be drawn from Canada's experience. During the period of exchange control in Canada, it was timidly assumed that, if controls were lifted, foreign investors, particularly American, would rush to repatriate their funds. Human

nature just does not work that way. Perversely, if obstacles are placed in the way, people do their best to overcome them. When freedom of movement is restored, second thoughts dictate a course of action based on judgment which, in the case of Canada, resulted in a tremendous movement of capital from abroad. It is true that Canada was in an early stage of development and tremendous advantages and profits could be foreseen in the development of her natural resources. Britain's position is, of course, very different. She has relatively no natural resources except the ability and virility of her people, but if history is any criterion these qualities should not be under-rated.

#### Position of Germany and France

It would not be amiss here to comment briefly on the position of the next two important countries of the West, France and Germany. Much has been written of the phenomenal recovery of Germany since the currency reform of 1948, and through hard work and wise management the *deutschmark* has become one of the hardest currencies in the world. Not only has she been able to participate in the restoration of convertibility for current account, but early in this year she abrogated all restrictions on the export of capital. Thus the *deutschmark* was made completely convertible both for external and internal purposes. The only remaining restrictions are merely for statistical record purposes, and German residents are now free to invest in foreign countries at will. No currency restrictions are in existence limiting the amount of funds that Germans may take abroad for travel expenses or for any other purpose.

Finally, a ray of economic and political sunshine comes from France. At the same time as the convertibility announcements were made, the French government announced a further realistic devaluation of the French *franc*. This brings the rate finally (it is hoped) to the same figure as prevailed before World War I with two zeros cut off it. In other words, the *franc* is now worth in dollars about the same as the *centime* was in 1914. This move would have been impossible with the former parliamentary set-up. The rest of the Western world looks with sympathy and confidence to General de Gaulle in his fight to restore stability to his country. It may well be that the General's sense of history and destiny will restore France to her rightful place in the western world in a shorter time than presently seems possible.

#### Restrictions Should be Removed

Importers and exporters in all countries can now breathe a sigh of relief that they do not have to worry about convertibility for current transactions. A pound is a pound, a *franc* is a *franc*, or a *deutschmark* is a *deutschmark* in anyone's hands, provided it is acquired in current merchandise trade or for services rendered. We can now concentrate our efforts on other restrictions on the free movement of goods and services. Quotas, embargoes and discriminating tariffs are still with us, but the *raison d'être* for most of these, namely, shortage of a particular foreign exchange, has disappeared. It should not be an impossible task to persuade the governments in Ottawa, Washington, London or Paris that the western world will be immeasurably strengthened by the removal of many of these restrictions.

Foreign exchange has too long been an instrument for the channelling and restriction of the free movement of goods, instead of a barometer, such as was the gold standard before World War I. The strength of the gold standard was, of course, that it was "above governments", and no government would have dared to revoke it except in dire emergency such as world war. It is too much to hope for a restoration of those conditions, as people will always remember that what has been done once can be done again. In other words, it would now

be quite impossible to restore the sanctity of a gold standard. We must perforce rely on such instruments as the International Monetary Fund, the International Bank for Reconstruction and Development and the General Agreement on Tariffs and Trade. It is to be hoped that in time they will acquire sufficient prestige to act as a serious deterrent to governments against the pursuit of unsound monetary and fiscal policies which will again throw the international exchange situation into confusion.

### Coins of the Realm

So far as the English monetary system is concerned, it may be traced back to the days before the Norman Conquest, and was based on silver: one pound, troy weight, of silver was the standard money unit. The pound was divided into 20 shillings, and the shilling into 12 pence. But, until the break up of the feudal system in England, coins were not required in any great quantity, for the majority of dues were met in kind, in the form of vegetable produce or services.

For a long time the only coin in general circulation in England was the silver penny, and it was not until 1257, during the reign of Edward III, that the first golden pennies were struck. About 100 years later gold florins were issued, to be followed in due course by the golden "sovereigns" which are still to be seen on occasions — suspended from an elderly accountant's watch chain. Gold, of which South Africa is such a large producer, is money in its most desirable and stable form, but there has never been a time in the world's history when there was really enough of this precious metal to satisfy all the needs. So its main function was as an auxiliary to the silver coinage, and even that no longer holds good. Today, in Britain, silver has been withdrawn, to be replaced by cupro-nickel, whilst gold has virtually disappeared from daily life.

— R. Robert, "The Many Forms of Money",  
*The South African Accountant*, September, 1958.

# Accounting Research

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## THE INDEPENDENCE OF THE AUDITOR

It has always been recognized that an auditor cannot properly perform his function if he is subject to the authority or control of those whom he is auditing. "Independence", usually defined as "freedom from external control or rule", is thus commonly recognized as a necessary characteristic of an auditor.

In the United Kingdom and Canada independence in this sense has generally been sought, at least in the case of limited companies, by providing in the governing statutes that the auditor must be appointed by the shareholders and report to them. Under these conditions the auditor's retention of an independent attitude to management becomes a contractual duty, and undue subservience to management's views or wishes involves not a mere loss of independence but a dereliction of duty or a breach of trust. With the auditor's independence apparently assured by contract and by statute in this way, British and Canadian writers have generally tended to ignore the idea of independence and to emphasize the need for honesty and integrity in carrying out the laid-down duties.

In the United States, on the other hand, the company auditor is normally appointed by the directors or by management itself. Since his primary contractual duty is thus to the management group, special provisions to protect the interests of sharehold-

ers and other third parties are needed. The development in American practice of the concept of "independence" and the emphasis on the auditor as an "independent accountant" are reflections of this need.

Unfortunately, the fact that the auditor's independence in Canada is typically assured by statute seems to have diverted the attention of Canadian practitioners from the problems that arise in those cases in which this protection is absent. The emphasis in Canadian literature on the purely legal nature of the auditor's responsibility based on his "contract" with the shareholders has resulted in too little attention being paid to those problems which arise when the auditor is *not* acting as shareholders' auditor. Such situations are not rare; most examinations of financial statements to be included in prospectuses, for example, or those prepared for specific creditors fall into this category. Somewhat similar problems are also found in audits of unincorporated businesses or of closely held companies in which the shareholders are actually the management.

In all such non-statutory audits the Canadian accountant faces the same basic problem as his American colleague — the possibility of a conflict between the interest of those who hire him and those who will be relying upon his report. He faces such problems, moreover, without the help of any authoritative exposition of the

principles which should govern such relationships. In American terms, he is without any official pronouncements on the nature of independence and the need to maintain it under such circumstances.

This is not to say that most Canadian accountants do not, in fact, act "independently". In actual practice, of course, they do. There is no question that the Canadian emphasis on integrity and professional competence in most cases results in the maintenance of an "independent" attitude. It does seem, however, that the failure to recognize the need for "independence" and to discuss the significance of the concept in practical situations may cause some inadvertent failures in this area. A review of the American views on the subject may, therefore, help to clarify the problems facing practitioners in such situations.

#### **The U.S. "Independent Accountant"**

The accounting profession in the United States has recognized "independence" as one of the essential qualities of the auditor for many years. The use in 1932 of the term "independent public accountant" to describe the person required to audit listed companies by the New York Stock Exchange merely confirmed the recognized practice. Further confirmation was given to the term by its inclusion in the Securities Acts of 1933 and 1934.

Since the concept of the "independent" auditor was made official in this way, numerous attempts have been made to define it. The Securities and Exchange Commission while recognizing that independence is a mental attitude, has been obliged as a government body charged with enforcing the law to concentrate on those external

relationships between the auditor and his client which suggest that independence may be lacking. The ethical codes of the American Institute and of the various State societies have also tended to emphasize externals for similar reasons. The Committee on Auditing Procedures of the American Institute, on the other hand, has emphasized that "independence" is a state of mind which cannot be defined by formula. This idea was well expressed in a statement issued in 1947 by the Council of the American Institute which concluded:

Rules of conduct can only deal with objective standards and cannot assure independence. Independence is an attitude of mind much deeper than the surface display of visible standards. These standards may change or become more exacting but the quality itself remains unchanged. Independence, both historically and philosophically, is the foundation of the public accounting profession and upon its maintenance depends the profession's strength and stature.

#### **U.S. Professional Standards**

In 1951 the American Institute of Certified Public Accountants published a booklet entitled "Codification of Statements on Auditing Procedure". The basic purpose of this publication was to summarize the series of bulletins issued on this subject over the years and thus to provide a convenient definition of the "generally accepted auditing standards" referred to in the standard form of American audit report. On the question of independence this statement reads as follows:

In addition to professional skill and competence, [the auditor's] independence must be assured if his opinions are to possess the impartiality necessary to make them dependable. To be independent he must be intellectually honest;

to be recognized as independent he must be free from any obligation to or interest in management, owners, creditors — or others entitled to rely on his report — which might influence his judgment as to the fairness of the financial statements.

This publication also reproduced the summary of "Generally Accepted Auditing Standards" approved by the members of the American Institute in September 1948. Item 2 of the "general standards" set out in this summary deals with the question of independence in the following terms:

2. In all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors.

Because of its emphasis on what might be called the mental nature of independence, the Institute does not attempt to spell out the implications of independence in any greater detail than is given in the above quotations. The distinction between the actual condition of independence and the appearance of independence is recognized. There are, however, no specific rules given for testing either the internal mental attitude or the external appearance.

#### U.S. Professional Ethical Codes

The rules of professional conduct of the American Institute make no specific reference to "independence". The following rules do, however, prohibit certain activities and relationships which would, at least potentially, have the effect of impairing independence or of destroying the appearance of independence:

**Rule 4** — The prohibition of occupations incompatible or inconsistent with public accounting.

**Rule 5** — The prohibition of an ex-

pression of opinion on financial statements of a publicly financed company in which the accountant holds a financial interest material in relation to the company's capital or the accountant's personal fortune. If a company is not publicly financed, disclosure of the auditor's interest to interested parties is considered adequate.

On the question of which occupations are inconsistent with the practice of public accounting the Committee on Ethics of the American Institute has given rulings which indicate that in their view management consulting or industrial engineering is not inconsistent with public accounting but that engaging in most commercial or financial enterprises, especially acting as broker of securities or loans, is not consistent with independence.

The question of the effect on independence of providing bookkeeping or accounting services has also been considered. In contrast to the views of the Securities and Exchange Commission discussed below, the American Institute has held that "If an accountant is in fact independent, and if he has performed all the auditing procedures necessary to supplement the information obtained through keeping the books, he should be entitled to express any opinion he has formed . . . disclosure of the fact that he has kept the books is not usually necessary."

#### Views of S.E.C.

The Securities and Exchange Commission is authorized by its governing statutes to require financial statements of registrants to be certified by independent public accountants. In rule 2.01 of regulation S-X the Commission discusses "independence" in these terms:

(b) The Commission will not recognize any certified public accountant as independent, who is not in fact independent. For example, an accountant will not be considered independent in respect to any person, or any affiliate thereof, in whom he has a financial interest, direct or indirect, or with whom he is, or was during the period of report, connected as a promoter, underwriter, voting trustee, director, officer or employee.

(c) In determining whether an accountant is in fact independent in respect to a particular registrant, the Commission will give appropriate consideration to all relevant circumstances including evidence bearing on all relationships between the accountant and that registrant or an affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

In applying this rule to specific situations the Commission has been very strict in its interpretations. The attitude seems to be that the existence of any relationship which might impair independence is presumed to do so. As a result, it seems that almost any auditor who has any relationship with his client apart from that of auditor is likely to be held to have lost his independence.

A further test applied to the accountant by the Commission is described in the following quotation from Accounting Series Release No. 37:

Perhaps the most critical test of the actuality of an accountant's independence is the strength of his insistence upon full disclosure of transactions between the company and members of its management as individuals; accession to the wishes of management in such cases must inevitably raise a serious question as to whether the accountant is, in fact, independent.

Some of the relationships between

accountants and their clients which have been held to impair independence are listed below:

1. Almost any ownership of shares in a client or affiliate by a member of an accounting firm or a close relative of a member has been held to impair independence. There have been a few cases, apparently, where a very small holding acquired before the accountant was appointed auditor and disposed of immediately have been permitted but such cases have been relatively rare.
2. The holding of any office in a client company or the offering of any non-audit services seems to be held to impair independence. The prohibited services apparently include bookkeeping and accounting despite the views of the American Institute to the contrary. This latter prohibition has been justified by an official of the Commission on the grounds that an audit must be a check on the work of another so that if the auditor writes up the books there is, in effect, no audit.
3. Activity in fields related to the client's business has been held to destroy independence with regard to any company in that business. For example, an accountant who acted as a security salesman for one dealer was held to have lost his independence in respect to other security dealers as well.

No official ruling has been found dealing with the case of an accountant who directly or through an affiliate provides management consulting services. It is understood, however, that the Commission has given informal opinions to the effect that such an accountant cannot be considered to be independent.

The views of the Commission are thus considerably more extreme than those of the Institute in several particulars, especially with respect to small investments in public companies and the provision of bookkeeping and accounting services. This latter question, however, is by no means resolved, and the professional bodies are still disputing what they regard as the over-zealousness of the Commission.

### Comparison with Canadian Practice

Despite the absence of any official requirement of independence in Canada, we have in our laws and rules of professional conduct a number of provisions similar to those which in the United States are considered to relate to this characteristic. Each of the Companies Acts, for example, prohibits, at least in the case of public companies, the appointment as auditor of anyone who is a director or officer of the company or who is a partner or employee of such a director or officer. Provisions to the same effect, or capable of this interpretation, also appear in some of the Provincial Institutes' rules of professional conduct. The carrying on of business activities which are inconsistent with the practice of public accounting is also prohibited directly or by implication in most instances.

There are, however, many other relationships which, even if they do not affect the auditor's ability to give an unbiased opinion, may make it difficult for him to remain impartial and even more difficult for him to

appear so. Such relationships include the ownership of shares in a client company, the offering to clients of non-accounting services, especially continuing secretarial or managerial services, the holding of directorships or salaried offices in companies doing business with or competing with clients, etc.

In view of the need for public accountants to maintain the appearance of complete impartiality, it may well be that some more specific regulations regarding such practices would be in the interest of the profession as a whole. The fact that many practitioners have adopted personal rules of conduct on these matters which are considerably more stringent than the professional codes suggests that, at least in some circles, there is recognition of such a need.

Another question which, although related to the above, can be considered separately is whether the practice and reputation of the profession would be improved by including "independence" in the American sense as one of the official characteristics of the public accountant. In many cases, of course, such a requirement would make no difference in the actual practice which is already as "independent" as any in the United States. The existence of such a formal requirement might, however, occasionally be helpful to a practitioner faced with a particularly difficult or unusual situation. The popular recognition of this characteristic of the profession would also promote a greater understanding of the significance of the auditor's report.

# *Administrative Accounting*

## **COST ACCOUNTING**

There is probably general agreement that the primary objectives of cost accounting are:

1. To provide management with information on which to reach decisions where consideration is being given to some important change in the company's field or scope of activity.
2. To aid in cost control (i.e. cost reduction).

The central dilemma, however, of this field of accounting was strikingly illustrated in an example given by Roland Chagnon, C.A. in his thought provoking address to the 1958 C.I.C.A. annual conference. He described as "incomplete and static" the statement that the operating cost of a car was 14c a mile.

He went on to say "In fact, the cost of 14c a mile is exact only if the car has travelled a definite number of miles, say 10,000. The cost of 14c will increase if the car runs less than 10,000 miles and will decrease if it runs more. To be more accurate and dynamic, the statement would give a better picture and allow comparison if it showed that the car costs a minimum of \$700 per annum to cover fixed expenses, such as depreciation, licence, insurance, interest and garage, and 7c a mile to cover variable expenses, such as gas, repairs and tires."

In most matters there is a natural human desire to provide simple finite answers. In regard to cost account-

ing, nothing seems to be more sensible than to ask what is the total cost per pound of product, allowing for all costs such as depreciation and administration. Unfortunately, this may be a field where the simple answer may not always be the best. It may have little value either for decision making or cost control.

To state that the full cost (including indirects) per pound of a product is, say, \$1 is precisely analogous to the car example in Mr. Chagnon's address. It may be an incomplete and static answer. It depends on two assumptions: (1) the volume of production, (2) the set of arbitrary rules used in allocating indirects.

The first assumption varies from month to month, and the second from accountant to accountant.

It may be useful to explore the following relationships which are fundamental to the cost accounting problem:

1. Variability
2. Directness
3. Controllability.

## **Variability**

It is common to think of costs in relation to production. Raw materials and direct labour are described as variable costs because they change directly with changes in production. Buildings, equipment and administration are usually described as fixed costs because they supposedly do not vary directly with production. Num-

erous expenses such as office costs, research and junior supervision fall somewhere between these two extremes.

There is, however, a third dimension, in addition to costs and volume, which is not always mentioned in this context. This dimension is time.

When raw material and labour costs are termed variable, what is really meant is that they can be increased or decreased in a short period of time to correspond with small changes in production volume.

If we choose a small enough unit of time, even direct labour for many plants may not be variable, but fixed. Similarly, a piece of machinery is a fixed cost only if we are considering a relatively short period of time, say, one year and a relatively small change in volume. If the period under consideration is a matter of years and the change in volume is very large, the cost of machinery (i.e. depreciation) may well become variable. In fact, all costs of a company, including depreciation and administration, are variable if they are considered in the context of a large enough change in volume and a long enough period of time.

What we are actually concerned with is the degree of variability. This is governed by the minimum amount (or size) of an asset or service which must be purchased in relation to the rate of consumption of that asset or service.

Raw materials can be purchased in very small quantities in relation to their rate of use. Direct labour can be acquired in small units in relation to the total consumption of this service in a given period. Both raw materials and direct labour, therefore, have a high degree of variability. The

services of foremen must be acquired in a large "package" in relation to the total need for such services during a year. Therefore, in a short period of time and for small changes in production, foremen's salaries possess a low degree of variability. A piece of equipment must be purchased in a very large unit in relation to its rate of consumption in the manufacture of goods. Depreciation on such an asset is a "fixed" cost, that will vary only with large changes in the rate of production and over a long period of time.

### Directness

Before an expense can be classified as direct or indirect we must ask the question: Direct to what? If we are considering a whole company, all expenses from the president's salary down are direct. If the unit being examined is a manufacturing plant, all expenses incurred at that location (including depreciation) are direct. Usually the terms "direct" or "indirect" are used in connection with individual products.

Whether an asset or service consumed in production is direct or indirect is determined by the minimum amount (or size) which must be purchased in relation to the amount consumed in the operation or product being costed. In Mr. Chagnon's example, "fixed costs" of depreciation, licence, etc. are all direct to the total cost of operating the car; they are indirect, however, to the cost of driving the car one mile.

### Controllability

The level of authority immediately responsible for controlling a cost tends to be closely related to the degree of variability and the degree of direct-

ness. The lower levels of supervision usually have the considerable control over expenses which vary promptly with small changes in production. Relatively fixed charges such as foremen's salaries and depreciation on machinery are the responsibility of more senior management, while the cost of buildings and executive salaries will probably be the responsibility of the board of directors. The logic behind this, of course, is simple. A decision to incur variable costs, such as labour, and supplies, involves few intangibles and any error in judgment can usually soon be corrected. The decision to incur fixed costs, such as a major construction project, requires the balancing of many intangible factors and an error in judgment can be disastrous. The consumption of raw materials is a variable cost which is controllable at a junior level; long term commitments to purchase raw materials are in the nature of fixed charges which must be approved at a high level.

A summary of the controllability of

costs as a function of variability and level of management is shown below.

### Cost Reports

Cost reports to each level of management should be geared to the responsibilities of that level. For example, a departmental foreman is interested only in those variable costs which he can personally influence, such as consumption of materials and labour, and cost reports to him should be restricted to these elements. Reports to senior management should show the factual story for expenses for which such managers are directly responsible. In addition senior managers need a summary of those operating results for which they are indirectly responsible, but which are directly supervised at a more junior level.

Some guides in deciding the appropriate costs to charge to and report to an individual are as follows:

1. If a person has authority over both the acquisition and the use of the

Type of Cost	Variability	Level of Management
Use of raw materials	<div style="text-align: center;">             High              ↑              ↓              Low           </div>	Low Foremen
Operating labour		
Supplies		
Maintenance labour		
Power costs		Plant or division managers
Foremen's salaries		
Long term commitments for raw materials		
Shops expense		
Junior administration		President or board of directors
Machinery & equipment		
Executive salaries		
Buildings		
Land		

services, he should be charged with the cost of the services.

2. If a person can significantly influence the amount of cost through his own action, he should be charged with such costs.

In considering cost accounting and reporting techniques, the question arises as to whether any useful objective is achieved by allocating indirect expenses to subsidiary operations or functions and finally to products. In many cases, as in the example of the car, this procedure tends to oversimplify the presentation of what is essentially a dynamic problem.

In costing, as in most accounting problems, the initial question to ask is what is the purpose to be served? The nature of the costs and reporting system will be governed by the purpose. As mentioned above the two main purposes of cost accounting are control or cost reduction and decision-making.

The function of control may be further analyzed as follows:

1. The communication of a plan or budget.
2. The motivation of responsible people to follow and carry out to the best of their ability the adopted plan or budget.
3. The appraisal of actual performance against the plan or budget.

Clearly, costs for these purposes must be essentially factual, dynamic

and related to individual responsibility. Moreover, the vital element in any attempt to control costs is to plan, i.e. to have standards which individuals can understand and accept as attainable. Historical costs show whether the plans were in fact attained and are useful only in so far as they lead to a better performance in the future. In other words, control can only be achieved before the fact. Nothing that has happened can be undone by cost reports no matter how detailed.

In the field of decision-making we are often dealing with major changes in the volume of production over a relatively long period of time. In this situation total costs including administrative and depreciation may become important. In fact as explained above such usually "fixed" costs are actually variable. Management will be interested in the change in total costs resulting from taking the proposed decision as against not taking it or taking some other course of action. Historical costs may well be valuable in analyzing such a problem and reaching a decision. However, much of the data for an intelligent decision will usually have to come from sources other than the company's recorded costs. Here again, any information to be of use must be dynamic. Static total cost per product figures produced as a result of many arbitrary prorations may well be of limited value in aiding the reaching of sound decisions.

## Current Reading

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### MAGAZINE ARTICLES

#### AUDITING

"ON BEING ARTICLED — A TALK TO UNDERGRADUATES" by H. D. H. Coulson, *The Accountant*, April 18, 1959, pp. 468-470.

Here is useful advice for junior accountants:

"... it is always well to stop and think how the work you are doing fits into the general scheme of things in the client's office. It may well be that you are checking what appear to be pieces of paper with books or vice versa. It would be wise to pause and think whether what you are endeavouring to do is to prove that the book contains a record of all the transactions it should contain, or whether the transactions in the book are supported by evidence that they are correctly so recorded. If you think for one moment, you will appreciate that if you are checking the payments side of a cash-book with vouchers confirming payment, your need is to see a voucher for every item in the cash-book. If, on the other hand, you are checking receipts into a cash-book and dealing, say with a counterfoil receipt book or similar evidence of that kind, you are looking to see that every item which should be in the cash-book is there. This may seem quite elementary but it is important always to bear in mind that the work has a purpose and to see that that purpose is followed in the way in which the work is done.

"Beyond this, it is also well to find out the part which the work you are doing plays in the audit as a whole or in the accounts of the business as a whole. In my experience, it is unlikely that a senior will be unwilling to give a word of guidance, if asked, but there is equally no doubt that the [junior] clerk who is prepared to apply his mind to thinking out the answers for himself and then testing out those answers in practice, will learn far more and be far more capable of doing his work properly ..."

"REVIEWING THE SYSTEM OF INTERNAL AUDIT" by Frank H. Tredemann. *The New York Certified Public Accountant*, April, 1959, pp. 257-265.

The independent auditor has a responsibility to his client to rely upon the system of internal audit as much as possible, but determining the extent to which he can do so requires a careful appraisal of the system. It is not the mechanics of the internal auditor's test of vouchers, payrolls and postings that is the basis of reducing the external auditor's scope. He cannot automatically examine one less voucher for every one the internal auditor checks. Reduction in the scope of the audit program made in reliance upon the system of internal audit is possible only when the public accountant is able to recognize the internal audit system as an effective part of the system of internal control.

Effective internal auditing depends

on many things. The internal auditor and his staff must be suited by training and temperament for their work. Audit programs must be well planned and executed. Reports must be clear and conclusive, and criticisms contained therein should be followed up promptly by management to insure that corrective action is taken. Finally, the internal auditor must report to a highly placed official and enjoy the support of management generally. Only if these conditions are met can the external auditor rely on the internal audit and consequently reduce the scope of his own examination.

If the independent accountant is to rely on the internal auditor's work, he must have confidence in the internal auditor. A first step in the appraisal process should therefore be to learn the qualifications of the internal auditor.

The internal auditor must not only have a knowledge of accounting and auditing techniques, but must also have a clear understanding of management's responsibility for the company's operations and the stewardship of its assets. In short, he must share management's viewpoint in his approach to his job. He must have imagination and perseverance in order to appreciate fully the significance of his findings and to follow them through to fitting conclusions. Finally, he must have the type of personality which inspires the confidence and support of management and the cooperation of executives and other employees whom he meets during the course of his examination.

The shareholders' auditor can determine whether the internal auditor has these qualifications; first, by inquiry as to his training and previous experience; secondly, through his contacts

with the internal auditor during the course of his work; and, finally, through his association with others who come into contact with the internal auditor and who are affected by his work.

"THE OPERATIONAL AUDIT — AN EXTENSION OF MANAGEMENT CONTROLS" by L. E. Seiler. *The Internal Auditor*, March 1959, pp. 9-17.

An audit of financial matters is readily acceptable to management. But the operational audit, which begins where the financial audit ends, is sometimes resisted by management. In the first case, the auditor is evaluating a system established by management; in the second he audits *management's compliance* with the system. A report on faulty, weak or ineffective operations reflects on the management of the department or division concerned. It is this fact that leads some managers, department heads, or other intermediate level executives to resent the internal auditor's investigations of an operational audit nature.

When he shifts over to operational auditing, from audits that deal with the internal control function, the auditor must learn to think as a manager. He must deliberately act, think and speak a different language when assigned to an operational audit. He must bear in mind that he is the representative of general management, not the representative of financial management.

Many auditors, especially those trained in financial auditing, feel somewhat at sea when assigned to an operational audit. In such instances, a lifeline back to financial auditing is often helpful. It would be a gross mistake, for instance, for an auditor wanting to review the operations of

the final assembly department to walk up to the manager of that department and say, "I am now going to audit your assembly process to see if it is properly managed." Such an approach would almost immediately close the door to that fine degree of cooperation which is needed from the manager or department head. A natural entry would be through an audit of payrolls, which leads to incentive pay, which leads to the supporting time studies, and the auditor is then deep into the operations of the assembly department. Or, if there is no incentive pay system, the audit of vouchers payable would lead into the audit of materials vouchers, which leads to bills of materials or materials requisitions, and the auditor finds himself back in the assembly department again.

The internal auditor should constantly remind himself that he is working for top management and that the operational audit is a direct part of management's overall control system. He must remember that even though he may follow an audit program, he is not working in a vacuum from a set of printed rules. He must be aware of management's activities and must stay in tune with management's viewpoint.

#### DISTRIBUTION COSTS

"HAVE WE A DECLINE IN ADVERTISING APPROPRIATIONS?" by K. H. Myers. *The Journal of Marketing*, April 1959, pp. 370-375.

During the last two decades there have been two conflicting trends affecting the relation of advertising expenditures to national income.

On the one hand, there are a number of factors which tend to make advertising more efficient and thereby

reduce advertising expenditures: increasing population, continued urbanization, consolidation of printed media, competition between new and old forms of mass media, advances in the art of media selection and utilization, trends toward product-line merchandising and improvements in media technology. These tendencies result in "built-in" recessionary pressures, largely independent of the performance of the general economy.

On the other hand, there are expansionary pressures arising from such factors as increased emphasis upon brand merchandising and self-service, and the need for more aggressive promotional effort as disposable personal income rises.

Since the 1920's the recessionary tendencies have prevailed over the expansionary pressures to the extent that advertising expenditures in relation to national income have declined to around two-thirds of the level of the 1920's. Other things being equal, an absolute decline in per capita exposure to advertising might have resulted. This was not the case. Instead, improved media efficiency permitted the 1957 advertising expenditures of \$60 per capita to purchase at least two-and-a-half times the exposure to advertising "space and time" as did 1929's expenditure of \$29 per capita. Thus, the consumer is more subject to exposure to advertising appeals than ever before; but, relative to his new level of income, the indirect cost of such exposure is less.

#### FINANCE

"THE ANALYSIS OF YOUR SPENDING DECISIONS" by George A. Taylor. *The Controller*, April 1959, p. 168 et seq.

In every spending decision the problem is simply: Should the extra

investment be made or rejected? The argument in favour of making the extra investment is the saving it brings, and the question is whether these savings are large enough to recover the extra investment with a satisfactory rate of return.

In order to have an extra investment there must always be two alternatives. However, there are always two alternatives, and one will always cost more than the other — unless they both cost the same, in which case you have no problem of any depth. In the final analysis the question must at least be reduced to: Should I continue what I am doing now or do something new? What you are doing now may be “nothing”, but you will still be comparing “something” with “nothing”. Analysis may show, in fact, that it is better to do nothing than what you propose to do. In any event, you always have two alternatives.

The criteria for selecting only those investments that contribute to the maximization of profit of the entire firm are:

1. The recovery of the money invested.
2. The payment of an acceptable rate of return on investment.
3. The acceptable rate of return must be higher than the firm's capital-use rate [the capital-use rate is the rate a firm is obliged to pay for the use of capital].
4. The acceptable rate of return must also be higher than the firm's cut-off rate [the cut-off rate is the minimum acceptable rate of return in approving or rejecting spending decisions].

All of these items are determined by mathematical analysis. In addition, there should also be a mathematical

analysis of the security of the investment by determining a probable factor of safety. But the required mathematics is easily within the grasp of the average executive. A number of problems in this article illustrate the application of the relevant principles.

#### MANAGEMENT

“PROBLEMS OF THE FAMILY-OWNED BUSINESS” by F. N. Parks. *The Management Review*, April 1959, p. 14 et seq.

This article treats the organization problems that arise in family businesses under five headings: problem of succession, development and retention of non-family management, conflicts of family interests, compensation of family and non-family members, and provision for growth. Selected organization concepts that have particular application to family situations may be summarized as follows:

1. Develop company objectives and organization plans first with a disregard for the family — then adjust to meet the compelling family interests.
2. Face the succession problem long before it becomes immediate, so that the transition is smoothly effected.
3. If possible, see that family candidates for succession get some experience outside the company. Make sure they have line-operating experience.
4. Go outside for a chief executive if the family can offer no competent candidate. Do not expect the new president to be able to handle immediately the personality problems as well as technical problems he will face.
5. Give non-family management a reasonable amount of responsibility and let them know where

- they stand. The same principle applies to minority family members.
6. Do not let family compensation needs distort a fair and equitable overall company compensation pattern. Use compensation to hold non-family management.
  7. Try to look at problems and make decisions without being emotionally influenced by family requirements. Recognize when the decision is being compromised for family reasons.
  8. Make sure that management control information is at least the minimum required.
  9. Conduct the affairs of the enterprise to create a management atmosphere of understanding and goodwill without being patronizing.
  10. Plan reasonably in advance for the inevitable day when the company is to "go public". Develop attitudes and concepts in keeping with the changing conditions.

#### BOOK REVIEWS

**"Inventories and the Business Cycle with special reference to Canada",** by Clarence L. Barber; University of Toronto Press; 130 pages; \$3.50.

One of the more difficult problems which confront businessmen and accountants is that of understanding and controlling fluctuations in inventories. Often seemingly well conceived plans to accumulate or reduce stocks are frustrated by sudden changes in demand. In this interesting book Professor Barber attempts to describe for the whole national economy the relationships governing changes in inventories, capital investment and national income. He employs a dynamic Key-

nesian-type analysis. An equilibrium level of income is defined as that income level where planned investment in durable assets is equal to planned savings. Before there can be a net accumulation of inventories for a nation as a whole, the national income must exceed the equilibrium level. Similarly no net reduction in inventories can occur unless the national income falls below the equilibrium level. Expressed in another way changes in inventories serve to bring actual investment (i.e. the net increase in both capital goods and inventories) into balance with actual savings.

For the accountant interested in broadening his perspective this study offers some insight into how individual corporate plans affect, and are in turn affected by, changes in the national economy as a whole.

J. W. CROWE, C.A.  
Montreal, Quebec

**"100 Years of Banking",** by Joseph Schull; Copp Clark Co. Ltd.; 222 pages; \$4.50.

In "100 Years of Banking in Canada", Joseph Schull tells the story of The Bank of Toronto and The Dominion Bank from their founding in 1855 and 1871, respectively, to their amalgamation at the end of 1954 as The Toronto-Dominion Bank.

Originally sponsored by a group of Ontario Flour Millers, the Toronto Bank was tentatively named the Millers' Association of Canada West. A period of great expansion came in the first six years of this century when 39 new branches were opened in Ontario and Quebec — three times as many as in the bank's previous 45-year history. The Dominion Bank busily

pushed its frontiers westward and in 1897 opened its first office in Winnipeg. An interesting incident in more recent years was a seemingly inexplicable 4-day run on The Dominion Bank in 1923. Eventually the panic was traced to a teller who, subscribing to the theory that English is intelligible to foreigners if very loud and clear, refused an immigrant's cheque marked n.s.f. with the alarming words "No money in the bank".

Cold, hard facts abound in the book but the author has most successfully put flesh and blood on the bones of banking. He has managed to depict the characters and personalities of the men who founded both institutions and has made very interesting their struggle with the problems that faced them in a new country with a rapidly

changing economy. The history of The Toronto-Dominion Bank is so closely allied to the development of the country as a whole that to read this book is to follow closely Canada's progress and industrial growth in the last 100 years.

R.E.

### BOOKS RECEIVED

"Business Report Writing", by R. D. Hay and R. V. Lesikar; Richard D. Irwin, Inc., Homewood, Ill., 1957, reprinted 1958; available in Canada from General Publishing Co. Ltd., Toronto; 352 pages; \$5.60

Recently reprinted, this textbook stresses principles of business reporting slanted towards the writing of reports. Its purpose is to train students to analyze, collect, interpret and present business information in a clear, concise style.

## *Tax Review*

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### THE BUDGET, 1959

On Thursday, April 9, Finance Minister Donald M. Fleming brought down his second budget. In June of last year, Mr. Fleming budgeted for a deficit of \$648 million which has now been reduced to \$617 million, with expenditures of \$5,387 million and revenues of \$4,770 million. For the fiscal year ending March 31, 1960, Mr. Fleming has budgeted for expenditures of approximately \$5,845 million and would expect revenues of \$5,165 million without changes in tax rates, for a deficit of \$680 million. With proposed increases in tax rates which Mr. Fleming estimates will produce some \$352 million, the anticipated deficit for the coming year will be \$328 million.

The tax increases were obviously necessary if one assumes that expenditures have been pared to a minimum, but it must be embarrassing to the Minister to recall certain statements made when he was a member of the opposition. For example, in 1954 the Minister said, "The effects of high taxes are having ever widening consequences. We see them reflected increasingly today in the high cost of production which is having secondary effects in this country of very serious significance. We see on every hand, every day, Mr. Speaker, the effects of these high taxes in the increasing costs of production, and they have been a major contributing factor in bringing

about a situation where our export trade has been falling off to a disturbing degree. Do you realize, Mr. Speaker, the extent to which, by reason of these high taxes and high costs we have been pricing ourselves out of some of our best markets abroad? The government seems to take no account of that fact, and no responsibility." These sentiments are still expressed by the Minister who said in his budget speech, "World markets are becoming increasingly competitive, and unless we can keep our costs of production in line with those in other important trading countries we shall find it increasingly difficult to sell our goods abroad and meet the competition of imports at home." Yet, in almost the same breath, the Minister of Finance introduced tax changes which will tend to increase commodity prices by at least \$223 million. The expenditures which the government proposes for the coming year of \$5,845,000,000 are the largest in this country's history, barring wartime, and it is wondered whether the proper course of action would not have been to reduce expenditures or at least hold the line.

In the opinion of Mr. Fleming, we are recovering from the 1957-58 recession and he optimistically predicted a 7% increase in the gross national product which is the second largest increase since the war, the greatest previous annual increase being 9%. With these improved prospects, Mr.

Fleming indicated that it would be unwise to continue to run deficits on the same scale as last year as it would increase inflationary pressures which would prove difficult to control a year or so from now. Apparently, the government has concluded that at this time it is more desirable to bring about a reduction in the anticipated deficit by increasing taxes rather than by decreasing expenditures, even though the increase in taxes will result in increased commodity prices and is likely to reduce the rate of growth in the gross national product. It may be, however, that since a much larger portion of the voters in Canada benefit from increased government expenditure than suffer from increased taxes, such an approach is sound politically.

The government's tax policy for 1959-60 is to be based on two principles—

- (a) To provide a broadly based source of revenue to meet the new and additional forms of universally available social welfare benefits.
- (b) To reduce the budgetary gap in a degree that will not interfere with the desired rate of recovery, but will hold out the prospect of a balanced budget at the appropriate time.

Mr. Fleming pointed out that the two principal elements of a continuing nature in the increased expenditures in 1958 and 1959 are the increased old age pensions and the new program of hospital insurance. In 1957, the Minister of Finance and the Prime Minister told the Canadian people that it was possible to increase old age pensions, make larger payments to the provinces and municipalities, cut income taxes and balance the budget. In his budget speech, the Min-

ister observed that these programs had been well received but that they cost money and must be paid for — two short years after he informed the public that they could be done for nothing! It is quite evident that the Minister has now discovered that expenditures cannot be reduced as easily as he had expected, and he is to be commended for realizing and admitting this fact. It is hoped, however, that his present observation will not be overlooked by a growing body of citizens to whom "cradle to grave" security has an increasing appeal provided that it is financed by the government. Even in our "travel now pay later" age, it is impossible to get something for nothing.

To finance old age pensions on an annual pay-as-you-go basis, Mr. Fleming has increased the 2-2-2 formula to 3-3-3. Contributions to the old age pension fund will now be 3% on personal incomes, with a maximum contribution of \$90, to take effect July 1, 1959; 3% on corporate incomes effective January 1, 1959 and a 3% sales tax which took effect on April 10. These new rates are estimated by the Minister to be adequate to maintain this fund in balance without requiring annual appropriations by Parliament to cover the deficits.

In addition to these tax increases for the old age security fund, the personal income tax rates on taxable incomes in excess of \$3,000 per annum have been increased by two percentage points effective July 1. It is indicated that this increase in rates will affect only about 800,000 of the 4,600,000 individual taxpayers. As for corporations, in addition to the old age security tax increase, the rate of corporate income tax has been increased by two percentage points on taxable in-

come in excess of \$25,000 per annum with effect from January 1, 1959. Consequently, corporations will now pay income taxes at the rate of 21% on taxable income up to \$25,000 and 50% upon the excess.

The excise duty on spirits was increased so that a 25-oz. bottle of whiskey will cost the consumer an additional 12c. The excise tax on cigarettes was increased by \$1 per thousand, or 2c per package of 20 cigarettes, and the excise tax on cigars was increased by \$1 per thousand. Although it has been observed that neither Mr. Diefenbaker nor Mr. Fleming smokes, it is unlikely that this influenced their attitude to any significant degree. It is interesting to observe, however, that in February, 1958 Mr. Diefenbaker told an audience of 1,400 that no industry in Canada suffers a greater degree of taxation than the tobacco industry. Tobacco growers, he is reported to have said, are the one segment of agriculture that has not received the attention it deserves although growers long have clamoured for Government aid. He even indicated at that time that the tax on cigarettes, cigars and tobacco might soon be cut.

As nearly as one can judge, tax increases were widely anticipated and, for the most part, such criticisms of the budget as have been heard to date have dealt mainly with the possibility of decreasing government expenditures. Nevertheless, it was optimistic of the Minister to say, "Many may not be unpleasantly surprised that the increases I shall be proposing are as moderate as they are" since the 1958 tax reductions were evidently well received by the taxpaying public. It would appear, however, that much higher rates at present would meet

with strong resistance especially when one considers the rates applicable in the United States. Corporations in Ontario will now pay the same rate of tax on income in excess of \$25,000 as U.S. corporations. The United States, however, does far more in the way of defence and foreign aid. While the public appears to accept tax increases meekly, it is submitted that at some point the camel's back will be broken and that point is dangerously near.

Although it is natural for the taxpaying public to be critical of any budget which increases taxes, it is appreciated that Mr. Fleming was confronted by a very difficult situation indeed. The existence of fairly widespread unemployment during a period when investors and businessmen are doing quite well creates a dangerous disparity which it is hoped will be resolved as the economy continues to recover from the 1957-58 recession. It is quite evident from Mr. Fleming's forecast that he expects a substantial recovery. Therefore he has taken steps to increase confidence in the government by investors and the business community which, if measured by the interest rate, was at a low in the fall of 1958. Whether he will succeed or not is a difficult question but it is interesting to observe that the rate for treasury bills two weeks before the budget was 4.22%, 4.33% one week before the budget and the day after 4.42%.

While it is the duty of the financial critic of the opposition to deprecate as best he can the efforts of the Minister of Finance, his criticisms this year may not be without substance. Mr. Benidickson perhaps summed up the attitude of the government's critics in the following motion:

"This House regrets the bad faith of the government, which sought and secured support from the Canadian people on a program of lower taxes, reduced expenditures and a balanced budget, and which has now produced, in flagrant disregard of pre-election promises, a budget calling for higher taxes, record expenditures and a large deficit."

In addition to the tax rate changes referred to above, the Minister proposed certain changes to the Income Tax Act and Excise Tax Act which, along with other amendments that will be contained in the amending bill, will be discussed in a subsequent issue. It would be appropriate at this time, however, to consider the Minister's proposal that the privilege of qualifying as a foreign business corporation be withdrawn. This proposal will not affect corporations already qualified as such but it does seem extraordinary to suddenly cancel such a longstanding provision without warning.

Section 71 presently provides that a foreign business corporation is exempt from tax but must pay a nominal filing fee of \$100. The effect of this provision is to permit Canadian and foreign capital to be domiciled and managed in Canada on a favourable tax basis provided that the business operations are carried on abroad. The only essential difference between a foreign business corporation and a true non-resident company was the privilege extended to such corporations to locate their management in Canada.

The provisions of section 71 provided certainty for corporations who were not sure as to whether or not they were resident in Canada. It is obvious that they will now make sure

of their non-resident status or seek to locate themselves elsewhere in a more attractive but probably less stable jurisdiction. While no reasons were given as to why this status was to be withdrawn, it can only be assumed that in this respect, Canada was regarded as a tax haven and that representations by other countries to eliminate the status had been received.

Another reason that might be given for the abolition of this type of corporation is that it is not availed of very often, since substantially the same effect may be arrived at through the incorporation of an ordinary Canadian company which carried on business in foreign jurisdictions through the medium of subsidiary companies. Income from these foreign operations is not subject to tax in Canada if it is received as a dividend from a foreign company of which the Canadian corporation owns more than 25% of the voting capital stock. It may even be that the uncertain application of the section in many situations contributed to its abandonment. However, this is all a matter of conjecture, and it would be interesting to have an opportunity to examine the reasons behind this unexpected change in the law, especially in the light of the Minister's observation that frequent tax changes can be upsetting and confusing.

With respect to the Excise Tax Act, an important and long overdue amendment has been introduced which extends the definition of producer or manufacturer to include any person who packages toilet articles, preparations, cosmetics or pharmaceuticals for sale except where they are packaged by a retailer in his retail premises for sale therefrom directly to

consumers or users. Many inequities were encountered prior to this new provision, and it is thought that the change will be welcomed by all except, of course, those who are no longer able to take advantage of the loophole. This new definition also applies to any person who markets, except by sale at retail directly to consumers or users, toilet articles, preparations, cosmetics or pharmaceuticals manufactured under his own brand.

### RECENT TAX CASES

#### **Incorporation of an Individual**

The appellant, a medical doctor, incorporated a company to which he agreed to transfer all his assets. He also agreed not to practise his profession in the municipality for a term of five years except as agent of the company. Subsequently, all revenues were treated as belonging to the corporation, the doctor receiving an annual salary only. The Minister disregarded the legal fiction of incorporation and taxed the doctor personally upon all income. The Income Tax Appeal Board upheld the Minister by ruling that the fees from patients were, in fact, earned by the appellant himself and were merely assigned to the company afterwards. The company could not practise medicine and was of no use to the appellant other than as his agent. The income was therefore fully taxable in the hands

of the doctor himself. (*No. 594 v. M.N.R.*). It is wondered whether this line of reasoning could not also be applied to commission agents and other small businessmen.

#### **Sale of Land and Buildings**

The appellant company sold the land and building used by it in carrying out its business activities for the sum of \$99,000 and allocated the sales proceeds entirely to land. The allocation of the full amount to land, which avoided the recapture of capital cost allowances, was undertaken because the purchaser demolished the building and used the vacant land as a parking lot. It was, therefore, quite evident to the appellant that the amount offered by the purchaser was entirely in respect of the land as the building had no value to him. The Minister, however, did not agree with this treatment of the sales proceeds and allocated \$31,000 to the building with a consequent recapture of capital cost allowances. By a somewhat tortuous line of reasoning, the Income Tax Appeal Board upheld the Minister ruling that although the building had no value to the purchaser, it did, nevertheless, have value to the vendor who had used it to house his business and who had insured it for \$30,000. (*No. 600 v. M.N.R.*). Once again the merits of tax planning are illustrated. If the vendor had demolished the building prior to the sale, no problem would have arisen.



## NEWS OF OUR MEMBERS

### **British Columbia**

A. D. MacIver, C.A. announces the opening of an office for the practice of his profession at 1071 Aragon Rd., Richmond.

Robert C. Ellis & Co., Chartered Accountants, announce the opening of a branch office in the Jacobson Agencies Bldg., Abbotsford.

L. D. Barnes, C.A. announces the opening of an office for the practice of his profession at 508 Hornby St., Vancouver 1.

R. B. Liverant, B.A., C.A. announces the opening of a branch office for the practice of his profession in the Times Bldg., Squamish.

A. G. DesBrisay, B.Com., C.A. and D. S. Hack, C.A. announce that they have assumed the practice of E. A. Campbell & Co., Chartered Accountants, Penticton. Henceforth the practice will be carried on under the firm name of DesBrisay, Hack & Co., Chartered Accountants.

### **Nova Scotia**

R. J. MacBurnie, C.A. has been appointed comptroller of the Halifax branch of Eastern Trust Company.

### **Ontario**

G. H. Edwards, C.A. has been appointed assistant general manager of Guaranty Trust Company.

H. B. Parkes, C.A. has been appointed assistant secretary-treasurer of Encyclopaedia Britannica of Canada Ltd., Toronto.

D. G. Campbell, C.A. has been appointed a director of Maclean-Hunter Publishing Co. Ltd., Toronto.

H. G. Lewis, C.A. has been appointed

resident Canadian director of Mills Steel Products Ltd., Toronto.

D. I. Webb, C.A. has been appointed head of Canadian operations of Merrill, Lynch, Pierce, Fenner and Smith, Inc., Toronto.

D. W. Burley, C.A. announces the opening of an office for the practice of his profession at 437 Queen St., Niagara Falls.

G. W. Mitchell, C.A., Ottawa, and D. G. Butterfield, C.A. and J. R. Steinhoff, C.A., Hamilton, Bermuda, announce the formation of a partnership for the practice of their profession under the firm name of Butterfield, Steinhoff & Mitchell, Chartered Accountants, at Rm. 8, 78 Bank St., Ottawa, with the appointment of G. W. Mitchell, C.A. as resident partner and Butterfield & Steinhoff, Chartered Accountants, Front St., Hamilton, Bermuda, as representatives.

G. R. MacGougan, C.A. has been appointed secretary-treasurer of Hendershot Paper Products Ltd., Hamilton.

C. S. Phillips, C.A. announces the removal of his office to Ste. 405, Board of Trade Bldg., 11 Adelaide St. W., Toronto.

### **Quebec**

David Solomon, C.A. announces the removal of his office to Ste. 21-23, 207 Craig St. W., Montreal.

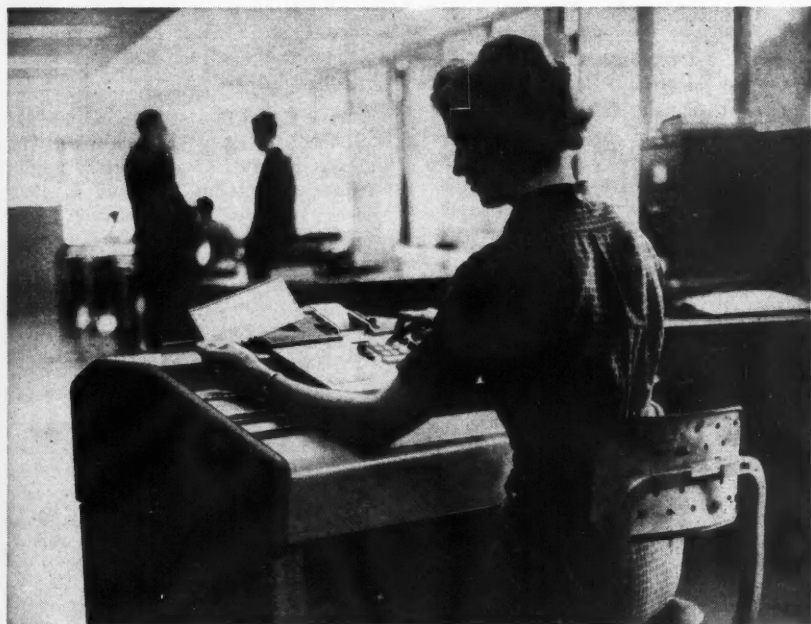
T. C. Davis, C.A. has been appointed assistant treasurer of the St. Regis Paper Company, Montreal.

C. S. Stephens, B.Com., C.A. has been appointed comptroller of Canadian Marconi Co. Ltd., Montreal.

*Continued on page 554*







## NEW KEYSORT TABULATING PUNCH

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OFFICES IN PRINCIPAL CITIES ACROSS CANADA

*Continued from page 552*

C. F. Topp, C.A. has been appointed secretary and controller of Henry Morgan & Co. Ltd., Montreal.

Pierre Comtois, C.A. addressed the Sherbrooke members of the Life Underwriters Association on April 2 at their monthly dinner meeting at the New Sherbrooke Hotel. His topic was "How an Insurance Man Should Prepare his Income Tax".

#### **Saskatchewan**

P. G. Larter, C.A., comptroller of The National Cash Register Co. of Can. Ltd., Toronto, has been named a director of the company.

### **OBITUARIES**

*We regret to announce the death of the following members:*

JOHN A. GRANT — on April 20, at the age of 95. A native of Cornwall, Ontario. Mr. Grant was admitted to membership in the Quebec Institute in 1907. He was active in the affairs of the Institute, serving on the examining board and as a member of Council from 1913 to 1915. He was president of the Institute for two terms, 1922 to 1924. He recently received a memento from the Institute in recognition of 50 years of membership. He was a partner of P. S. Ross and Sons in 1908 and remained with the firm until his retirement in 1945.

GUY WILLIAM SMITH — A senior partner in Gunn, Roberts & Co., Chartered Accountants of Toronto. Mr. Smith, 71, died in hospital on April 19. He was admitted to the Ontario Institute in 1922, elected a Fellow in 1944, and was president in 1949-

50. He was the first president of the Public Accountants Council for the Province of Ontario and was a one-time governor of the Canadian Tax Foundation.

THOMAS E. SAUL — At Lakeland, Florida on March 8, 1959 in his 68th year. Mr. Saul was admitted to membership in the Manitoba Institute in 1923 and in 1929 became associated in partnership with James M. Dunwoody in the firm presently known as Dunwoody, Saul, Smith & Co. He was elected a Fellow of the Manitoba Institute in 1956. He was for ten years the Provincial Commissioner for Manitoba of the Boy Scouts Association, and was a past president of the Empire Club.

ALEXANDRE LaHAYE — le 11 décembre 1958, à l'âge de 37 ans. M. LaHaye avait fait ses études à l'Université Laval et y avait obtenu une maîtrise en sciences commerciales. Il avait fait son stage chez Messieurs Boulanger, Fortier, Rondeau & Cie et avait été admis à l'Institut de Québec en février 1954. Il devint par la suite contrôleur de Legrade Inc., de Québec, et occupait encore cette position au moment de son décès.

CECIL W. NICHOLL — Passed away in Vancouver on April 29 following a heart attack earlier in the month. Mr. Nicholl was born in Ireland and came to Manitoba at an early age. He was admitted to the Manitoba Institute in 1927 and to the B.C. Institute in 1944 when he commenced to practise in Victoria. Since 1956 he had been in practice in Vancouver. In World War II Mr. Nicholl received the Order of the British Empire for "valuable public service" while serving with the R.A.F. Commonwealth Air Training Plan.

*The editor welcomes information for this column. News of members and provincial Institutes' activities received up to and including the 13th of the month will appear in the following issue of the journal.*



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C. A. Pollock, President, Dominion Electrohome Industries Limited

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## INSTITUTE NOTES

### ONTARIO INSTITUTE

**F.C.A.'s:** M. A. Bradshaw, the president of the Institute, has announced the election of the following members as Fellows of the Institute for distinguished service to the profession: Ball, K. W., Bavis, J. W., Beard, F. N., Broadhead, J. F., Browning, G. E., Campbell, F. B., Clarkson, G. P., Cowle, R. C., Crawford, L. C., Frost, A. J., Gaviller, C. F., Gorman, M. J., Grundy, G. E., Harper, S. E., Harvie, W. F., Hill, J. K., Hogben, W., Innes, J. S., Kane, R. J., Lewis, H. G., MacDonald, W. L., MacKechnie, C. C., MacKenzie, H. A., McDougall, W. J., McLeod, G. D., Moore, J. H., Norwood F. L., Orr, J. A., Palin, F. R., Parish, A. W., Parkinson, R. M., Ross, J., Ross, W. G., Saunders, R. E., Shakespeare, W. C., Shulman, J. J., Smith, St. E. V., Spry, C. H., Stone, F. R., Taylor, R. B., Thompson, W. G., Tyndall, C. L., Watson, A. G.

The new Fellows received their certificates from the president at a reception held in the Granite Club, Toronto, on May 21, 1959.

**Public Forum:** Considerable publicity resulted from the rebroadcast of a series of tape recordings made during an Institute-sponsored public forum on Income Tax, held in Toronto in March. Up to the end of April, the forum was broadcast by 24 radio stations outside Toronto and by two Toronto stations. As a public service in connection with the forum, Toronto members of the Institute gave written answers to 140 correspondents who wrote to the forum with personal tax problems.

### QUEBEC INSTITUTE

**Provincial Conference:** The third annual provincial conference of the Quebec Institute and the 79th annual meeting will be held at Macdonald College, Ste. Anne de Bellevue, Que. on Monday and Tuesday, June 15 and 16. The registration desk will

be opened on Sunday evening, June 14. The annual meeting will take place at 3.15 p.m. on Monday, June 15.

An active committee is preparing a program that will be attractive to both practising and non-practising members. Most of the sessions will be in the form of either panel meetings or discussion groups. Some of them will be in English, some in French, others in both languages.

Among the topics being considered for discussion in English are: a new look at depreciation, financial and cost forecasting, defalcations and the auditor's liability, function of accounting in control of maintenance costs, techniques for review of internal accounting controls, consideration of internal accounting reports, capital expenditures and standards for return on investments, and audit of profit and loss statement.

Some of the subjects to be conducted in French are: l'évaluation des inventaires — discussion en petits groupes, suivie d'une discussion générale, les sources de crédit et de capital pour la petite entreprise, les techniques de revue des procédés comptables, la vérification de l'état de profits et pertes, les modes de rémunération de la direction et l'incidence des impôts sur le revenu.

Feature speaker of the conference, who will speak at the Monday luncheon, will be T. R. McLagan, O.B.E., president and general manager, Canada Steamship Lines Ltd. Mr. McLagan will discuss the Seaway and its potential effect on Montreal and the Province of Quebec.

During the conference special honour will be paid to father-and-son pairs of Institute members, and all such "combinations" are especially urged to attend.

The Conference Committee is headed by K. P. Farmer, chairman, who is ably supported by D. P. Cassidy, Jerome Carrière and A. S. Cunningham.

*Continued on page 558*

## CLASSIFIED ADVERTISEMENTS

*All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.*

*Rates: Positions wanted, \$7.00 per column inch; Positions offered, \$10.00 per column inch; Open rate, \$17.00 per column inch.*

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**FOR SALE:** Small accounting practice in Toronto. Box 896.

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**FOR SALE:** Expanding Chartered Accountant's practice in central, western, Ontario. Grossing about \$25,000.00 per annum. Consideration one year's fees. Terms cash. Box 903.

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**PRACTICE WANTED:** Jewish Chartered Accountant in Montreal wishes to purchase small or medium sized practice, or to enter into partnership with a view to eventual purchase. Box 897.

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**C.A. (Protestant, age 53)** with small practice in Montreal and good commercial and taxation experience seeks position where opportunity afforded to serve existing clients. Box 893.

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**EXCELLENT OPPORTUNITY** in South Western Ontario for chartered accountant who wants to establish own practice. Box 894.

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**WELL-ESTABLISHED** Toronto firm of chartered accountants with expanding practice has opening for young C.A. of ability and good personality. Please detail experience, salary requirements and personal background in full. Box 898.

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**C.A. or SENIOR STUDENT** required for expanding C.A. practice in Southwestern Ontario. Partnership prospects are excellent for young man with management abilities and desiring a career in public accounting. Reply in strictest confidence stating education, experience, age, marital status and other personal details to Box 899. Enclose recent photograph if possible.

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**AVAILABLE:** Chartered Accountant, B.Com., R.I.A., age 26, desires position anywhere in Canada with progressive industrial or commercial organization. Box 902.

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**CHARTERED ACCOUNTANT**, young, intelligent and ambitious with 6 years experience in small public accountant's firm in Toronto. Desires association with C.A. firm anywhere in Ontario with partnership prospects. Box 904.

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**CHARTERED ACCOUNTANT**, B.Com., Jewish, 32, broad professional and industrial experience desires part time work with C.A. firm or full time position with partnership prospects. Montreal area. Box 901.

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**MONTREAL C.A.** with nice medium sized practice seeks association or partnership with similar member in order to effect economy of operation, efficiency of administration, protection in the event of illness. Box 900.

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### CHANGE OF ADDRESS

Members and students who change their address and advise The Canadian Institute of Chartered Accountants of such change should also notify their own provincial Institute.

Periodic reconciliations of mailing lists are carried out but to ensure prompt receipt of all provincial Institute mail, it is essential that the secretary of the provincial Institute be notified directly.

## Order Form

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*Continued from page 556*

#### B.C. INSTITUTE

**1959 Annual Meeting:** The 54th annual meeting of the Institute will be held in Vancouver on Thursday, June 11, and Friday, June 12. The following tentative schedule has been drawn up:

Thursday a.m., Technical sessions — U.B.C. campus.

Thursday noon, "Cold plate" luncheon — U.B.C.

Thursday p.m., Technical sessions — U.B.C. campus.

Friday a.m., Annual business meeting — Hotel Georgia ballroom.

Friday noon, Members' luncheon — Hotel Georgia ballroom.

Friday p.m., Special meetings to discuss  
(a) proposed revisions to the by-laws pertaining to professional conduct.  
(b) policy in employing articled clerks.  
—Hotel Georgia Ballroom and York Room.

Friday evening: Annual spring dance — Hotel Georgia Ballroom.

#### QUEBEC STUDENTS

**Forums:** A forum in the French language on "Undistributed Income" was held in the assembly hall of the Institute on May 19. Discussion leader was Jacques Paré.

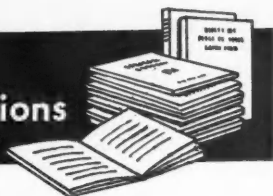
Twin forums, one in English and one in French, on June 2 and 4 dealt with the new Estate Tax Act. Speakers for the French forum were Jean-Guy Cardinal, secretary, Trust Général du Canada; and for the English, W. J. Hulbig, associate general counsel, Sun Life Assurance Company of Canada.

#### EDMONTON STUDENTS

The members of the Chartered Accountants' Students Society in Edmonton were guests recently at the local branch office of the International Business Machines Co. Ltd. for two lectures.

The lectures, which were arranged especially for the society, were given by Mr. W. B. McMinn, B.Sc. who is an applied science representative for International Business Machines Limited.

# List of C.I.C.A. Publications



## BOOKS and BROCHURES

### FINANCIAL REPORTING IN CANADA, 2nd ed., 1957

Designed for those who plan and prepare financial statements (members \$4.00) **\$5.00**

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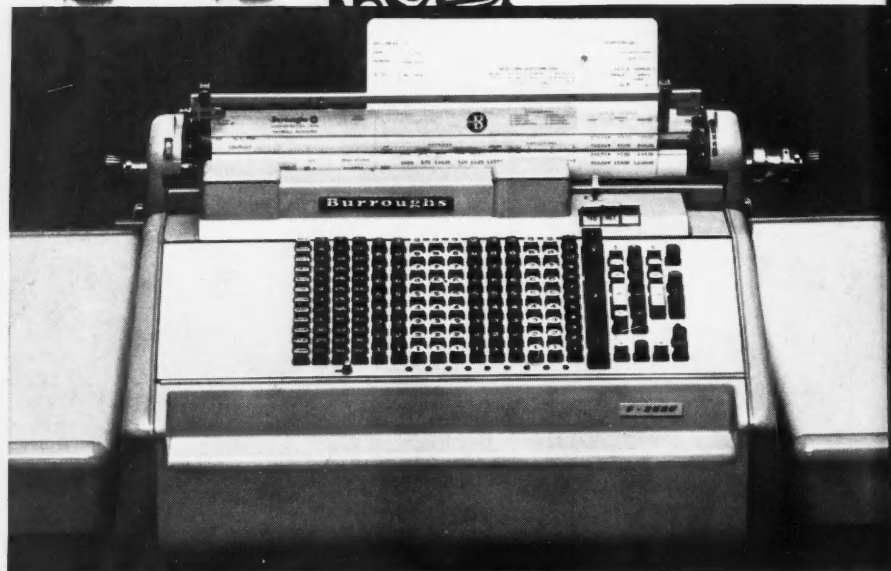
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9.	1	3.	2
1.2	6	1.	-4
14.3	1	3.	-2
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